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No-Load Mutual Fund Selections & Timing Newsletter
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C-lect Hybrid

How to know when to Hire and when to Fire Hybrid Fund Managers to keep your portfolio doing what you want it to do

July, 2014

Having talked with thousands of investors over the years, I find what investors really want is to try to maximize return and minimize risk of loss. The goal is simple enough, but the question is how to accomplish this? Many advisors answer the question with an age-based scheme or with a fixed, static allocation between stocks and bonds model. If they're "sophisticated", they'll suggest rebalancing the portfolio once a year. Other managers will focus only on their singular style area of expertise whether it is providing the most return for the risk taken or not. This Special Report answers the question.

For the last 30 years, I have been ranking mutual funds' by C, my proprietary risk-adjusted relative strength number; the higher the C the better. This is my answer to the question. Allocate your portfolio toward those funds with the highest C ranking, while avoiding the funds with the lowest. This is a proactive, rotational allocation methodology that strives to invest with the funds that provide the most return with the least risk.

C works. So, the C strategy remains the same, but going forward what I am changing is my application of C. I have begun to narrow its focus from an 800 fund pool to fund styles (like hybrid, small cap, etc), as well as to fund families (Vanguard, Fidelity), to sectors, to ETFs, and to 401k plans. Rank the funds by C. Buy the leaders, rotate through them. More Special Reports are planned for these things. As I have said many times over the years, if I could find something that was better (defined by the same metric: maximized return and minimized risk) than what I was doing over the whole period, and not just for one particular bull market or a bear market, I would make changes. I believe this more narrow application of C answers this requirement.

Think of it this way, we now have a pool of 35 hybrid managers who are all daily competing to be the very best way for you to invest your investment dollar. They use a variety of tools, allocations, contacts, and strategies, have centuries of combined experience, manage combined billions, and concentrate specifically on their expertise amongst the different markets. The questions remain the same. Which one to buy? Which one to avoid? Do we buy and hold? Do we rotate with the leaders? How do we know? Again, we rotate with the leaders by C. In fact we find their C ranks, their returns for their risk taken, absolutely will change over time as the stock and bond and domestic and international markets move through cycles of bull (up) and bear (down). Per their biases or their prospectus', they invest a certain way whether the markets "cooperate" with that assessment or not. Sometimes they are at the top of the scoreboard. Sometimes they are at the bottom. They do their unquestionable best, but markets change, even if they do not. So, how do we know when to hold them and when to fold them? My answer is by C. Rank them monthly. Pick the top from the list. Repeat.

While the selection strategy is not changing, the timing approach is changing in a fashion. Nearly always for this hybrid rotational allocation model, it will be a fully invested always strategy. What about bear markets in which stocks might decline 50% or worse? As you will find, the fund managers that take defensive measures in bear markets will rise to the top by C. There are times cash is providing the most return for the risk taken. I continue to recognize this, but with the more focused pool, the leaders by C the most return for risk taken strategy, the timing tactic is essentially built into the C rank. As you will see in this Report, the back tested results compared to MAAP Balanced Portfolio show downside risk was about the same, but the upside return was better. This warrants the change.

So, for MAAP Balanced in No-Load Mutual Fund Selections & Timing Newsletter, I will begin using this C-lect 2 Hybrid rotational allocation strategy. After all, hybrid funds are balanced funds, having various combinations of stocks, bonds, and cash. This will be its focus.

With these things in mind, this Special Report is on C-lecting in the hybrid sub group.

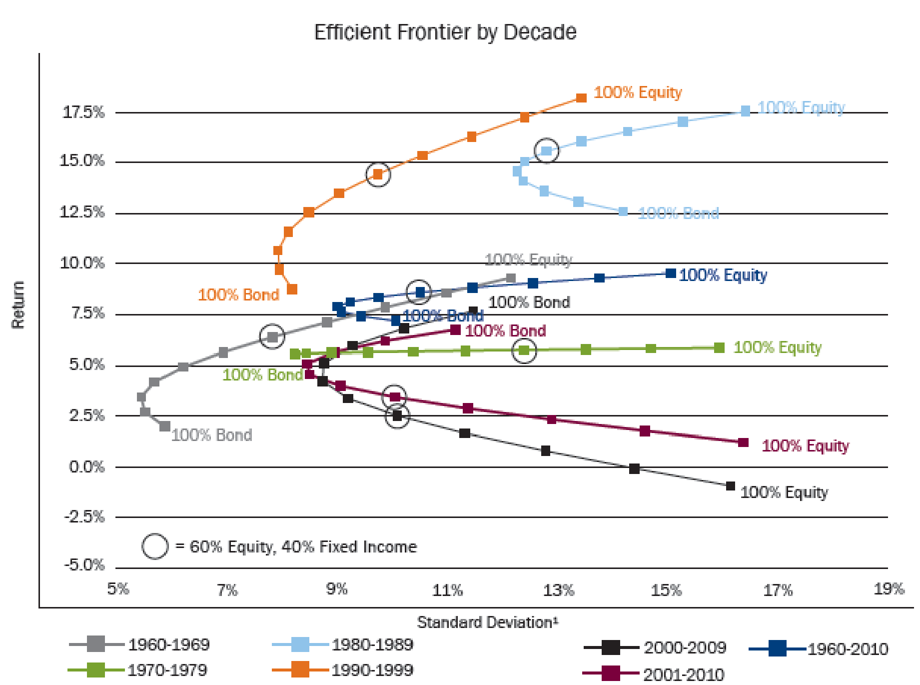
C-lect 2 Hybrid DESCRIPTION

C-lect is an active rotational allocation investment strategy to manage the mutual fund and ETF choices based on their risk-adjusted relative performance rank each month. We do all of the back-end work to arrive at each fund's number. Then each month we provide you with the list, including the two top hybrid fund choices to buy or hold. When a leader lags, we suggest selling it, and replacing it with the new leader. If the fund continues as the leader, we continue to hold.

As it turns out, we may loosely compare this approach to the efficient frontier concept of Modern Portfolio Theory. One difference is my recognizing and accounting for the fact that the efficient frontier actually shifts and changes over time. We want to invest the portfolio toward the cusp of the efficient frontier where return is maximized and risk is minimized. This will be some combination of stocks and bonds. It moves.

Many investors are aware of the traditional fixed 60% stock and 40% bond allocation, but most are unaware from where it sources, which is to a snapshot of the stock and bond market capitalizations in the 1950s (Harry Markowitz). The world has long changed since then. Moreover, the reality is that the efficient frontier itself shifts and changes dramatically, as most investors well know, over the decades. For our part, therefore, we attempt to meet the efficient frontier monthly where the specific area lies of some ongoing fluid percentage combination of stocks, bonds, and cash where return is maximized and risk is minimized. We rank and rotate through the leaders.

This chart, courtesy of Guggenheim Partners, shows the shifting efficient frontier.



As you can see, to remain close to the cusp where return is maximized and risk is minimized over the decades, an active allocation strategy is required. A fixed allocation will not achieve the goal. There are times to use cash, times to use bonds, times to use stocks, and times to use various allocations of each. We let the fund managers make their allocations and choices. We just rank them by C and rotate through the fund leaders over time. They might not change with the market changes, but we will change managers as the markets all wax and wane.

For the available hybrid funds in this plan, we rank them monthly and invest with the two top funds, participating in whatever expertise they are using that propels them to be making the most return for the risk taken. We repeat this exercise each month. At any point, stocks might be the area to invest that meets the most return and least risk parameter. At other times, bonds might be the best area. At still other times, a combination may be the best. This shifting target shows on the chart above. Lastly, there are times when cash is providing the most return with the least risk. There are many very smart managers. The C-lect strategy takes this all into account, managing the managers.

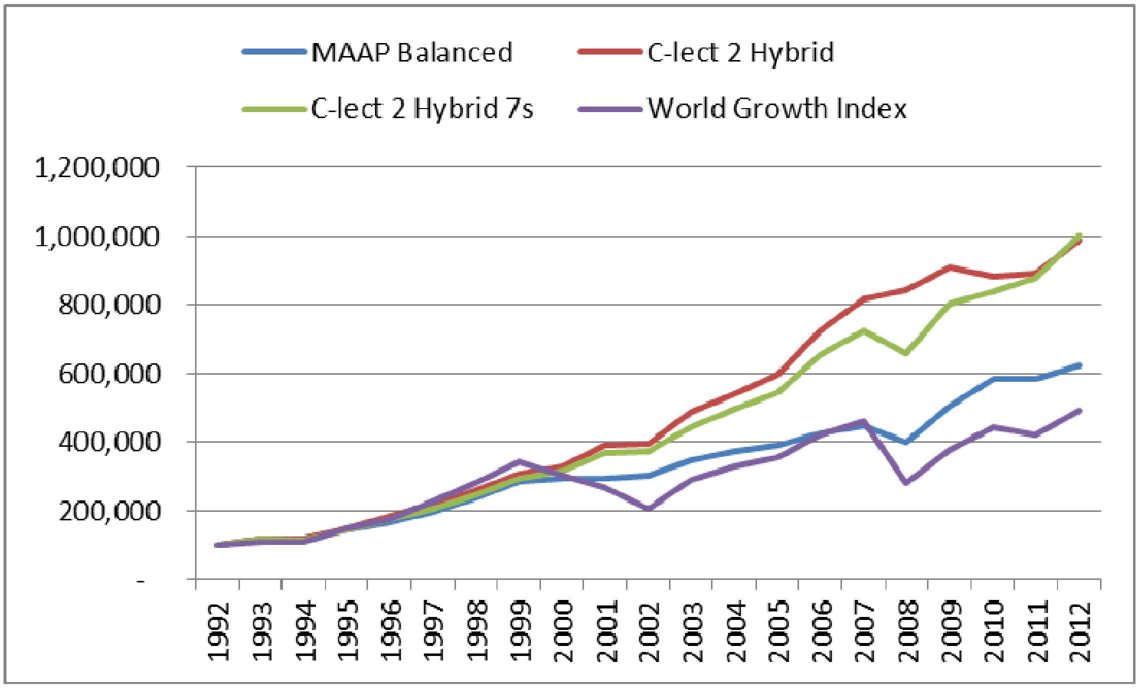
Many investors are typically taught two alternative investment philosophies. One is an age-based scheme. Two is a static balanced approach. The truth is your personal age has nothing to do with your manager's performance or market risk. The fact is that the efficient frontier, which is what every investor wants (most return and least risk), shifts dramatically over time. A fixed balanced approach also may not achieve the goal. Thus my methodology stresses the ongoing proactive allocation that strives to provide the most return with the least risk.

In short, C-lect is intuitively simple to grasp. Based on C, the risk-adjusted relative performance number, it ranks the hybrid funds on a monthly basis. The higher the C result the better. The hybrid fund choices will range with their internal varying allocations to stocks to bonds to cash and to domestic or international. The model then picks the top two leaders. On an ongoing monthly basis year after year, after meeting a minimum holding period (typically three months), the model then rotates through the choices as the stock and bond markets rally and decline, as the efficient frontier shifts and morphs with changes in risk and return.

Incidentally, for investors or institutions with portfolio sizes greater than $2 million, this hybrid strategy may be expanded with more rankings to accommodate larger sized portfolios.

PERFORMANCE COMPARISONS

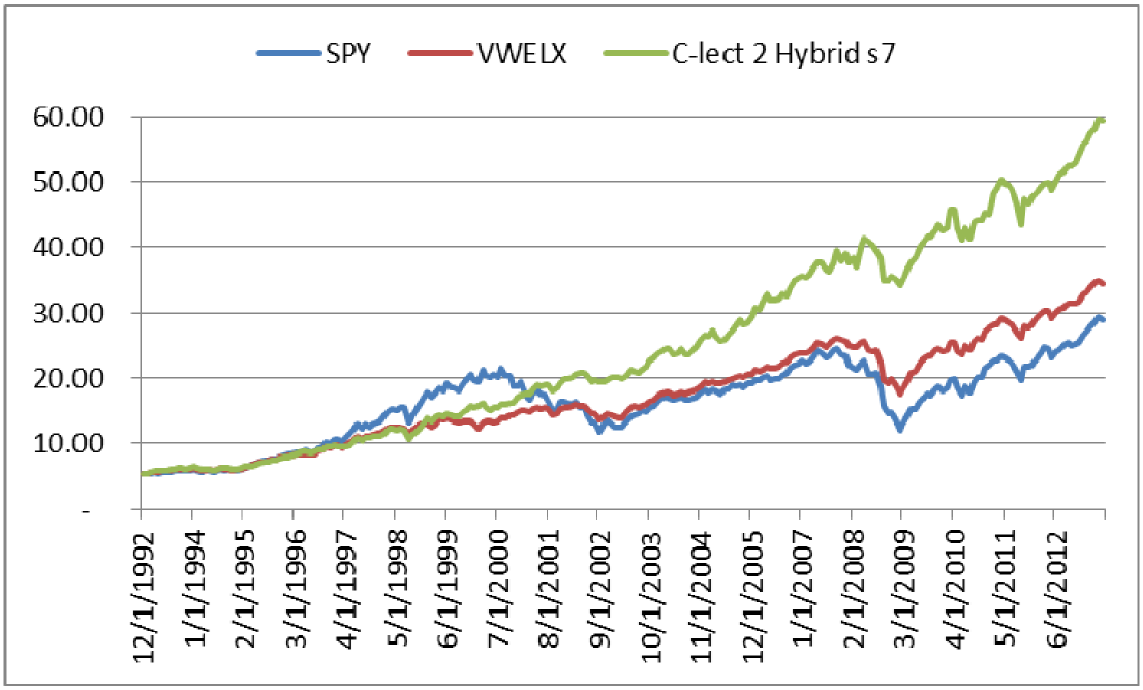
This first chart compares annual returns of C-lect 2 Hybrid, C-lect 2 Hybrid 7s, MAAP Balanced Portfolio from NLMFS&T Newsletter, and the World Growth Index (20% each fully invested in EEM, EFA, IWM, QQQ, SPY). The World Growth Index slightly outperformed SPY (S&P 500 index) over the same period.



This result is the prompting for making the MAAP Balanced Portfolio change. While the MAAP Balanced Portfolio outperformed the World Growth Indes, the C-lect 2 Hybrid models outperformed both. The downside losses were comparable between the two. In effect my striving to provide the most return and the least risk would be better achieved by applying C on the hybrid sub group. Thus the change.

Two C-lect 2 Hybrid models are shown for those who have larger portfolios and require more choices. Please email me for further details and additional models, if your portfolio exceeds $2 million. For NLMFS&T Newsletter, I will use C-lect 2 Hybrid 7s because, based on the back test, it is slightly less active on a monthly basis without impacting the resulting risk and return numbers. The two Hybrid strategies ended the period at essentially the same amount. All four portfolios started with $100,000 and 20.5 years later ended at about $1 million for the two C-lect 2 Hybrid portfolios ($990,000 and $1,002,000), while MAAP Balanced Portfolio ended slightly at $623,000 and the World Growth Index ended about $493,000

The next chart compares monthly returns of C-lect 2 Hybrid s7 with SPY (S&P 500) and VWELX (Vanguard Wellington, a traditional 60% equity and 40% fixed income hybrid fund). Each began at $5.40.



This chart compares the three strategies over the same 20.5 year period. The green line is C-lect 2 Hybrid s7, the blue line is SPY (S&P 500), and the red line is VWELX (Vanguard Wellington). The period covers both secular and cyclical bull and bear markets. See assumptions below.

In the secular bull period ending in the year 2000, SPY outperformed the other two choices. Return compensated for the risk. Stocks, however, do not trend upward in a straight line forever. Return fell far short of the risk; it then lost about 50%. With the C-lect 2 Hybrid rotation strategy, it ended that bear market higher than at its start. In the subsequent bull market, all three choices advanced. In 2008, the market then declined again by another 50%. VWELX was hit during this period also. The C-lect 2 Hybrid "portfolio" hit new highs within seven months of the bottom, while VWELX took about two years to finally recover. Since then all three have continued to advance.

The following shows the average annual gain for each approach (C-lect Hybrid s7 is rotate with the hybrid leaders, SPY is buy and hold a low cost index fund, VWELX is buy and hold a generally consistently fixed allocated balanced fund of 60% equity and 40% bond) and the best and worst funds in the hybrid pool over the same time frame.

C-lect 2 Hybrid s7	SPY	VWELX	best fund	worst fund
12.4%	8.6%	9.5%	PRWCX 10.8%	FASIX 6.2%

Rotating through the top C-lections over the test period provided the best results. PRWCX was employed by us five times, while FASIX was not employed by us at all. It is interesting to note that rotating through the leaders by C led to the top performance out of all choices.

The issue going forward, as always of course, is what about the future? Which fund or manager will provide me the most return with the least risk? No one knows which of the available funds or managers will do best next year or next decade or next century. Why guess we ask? Still worse, no one knows where the efficient frontier of some stock and bond and cash allocation designed to maximize return and minimize risk will range in the future. Why speculate? Instead, we employ a proven rotational allocation strategy. There's no guesswork; there's no speculation. The strategy actively rotates through the top funds based on their risk-adjusted relative strength ranks each month. Hence, C-lect ends up where we want to be; that is, investing toward the leading edge of the efficient frontier where return is maximized and risk is minimized.

ANNUAL RETURNS

Annual Return	VWELX	C-lect 2 Hybrid s7	MAAP Balanced (NLMFS&T Newsletter)
To 6/30/13	8.7%	9.9%	5.6%
2012	12.6	13.9	7.0
2011	3.9	5.1	-0.1
2010	10.9	4.2	15.4
2009	22.2	22.1	26.7
2008	-22.3	-9.3	-11.1
2007	8.4	10.7	5.2
2006	14.9	20.0	9.6
2005	6.8	10.4	4.0
2004	11.2	12.0	7.9
2003	20.7	19.1	14.6
2002	-6.9	1.1	2.1
2001	4.2	15.5	1.4
2000	10.4	8.5	2.4
1999	4.4	19.2	19.8
1998	12.1	19.0	19.4
1997	23.2	16.7	19.3
1996	16.5	22.7	16.0
1995	32.9	27.2	19.7
1994	-0.5	-2.6	1.0
1993	13.5	16.5	19.2

WORST DRAWDOWNS

	Annual	Inter-annual
C-lect 2 Hybrid	-9%	-17%
VWELX	-22	-33
SPY	-37	-52
MAAP Balanced	-11	NA

TEST FUNDS

The following are the 35 funds used during the test period. These may change in real time, depending on a number of factors including availability.

ACIGX

BERIX

BUFBX

CBLFX

DODBX

EXDAX

FAMRX

RASIX

FASMX

FGBLX

FPACX

FPURX

GRSPX

JABAX

LCORX

LOMMX

MAPOX

MOBAX

OAKBX

PAXWX

PRPFX

PRWCX

RIMBX

RPBAX

SIBAX

TRIGX

TWBIX

VBINX

VGSTX

VILLX

VLAAX

VWELX

VWINX

WBALX

WEBAX

ASSUMPTIONS and CAVEATS

Number of available fund choices was 35.

90-day holding period required before selling a position to avoid brokerage fees.

Two fund maximum held at any one time (50% allocation into each).

Account was always fully invested in a hybrid fund.

No commissions to buy or sell.

No fund short-term redemption charges (if any) were applied.

Dividends and capital gains reinvested.

No contributions or withdrawals were assumed during the period tested. The "account" only started with X amount that ended at Y amount.

For the test, one fund's sell and buy rebalanced both funds held, though in real time, one sell buys one fund for the same dollar amount would be practiced.

MAAP Balanced annual returns include the assumed annual 2% management fee added back into what is shown in the annual NLMFS&T Newsletter results.

Test period is from 12/31/1992 through 6/30/2013, which includes both secular and cyclical bull and bear markets. There is no guarantee future periods will be equivalent or even similar to past periods.

Not all of the current fund choices were available to buy and sell over the entire period.

Raw mutual fund and ETF data is from FastTrack. They adjust fund prices for dividends and capital gains.

Past performance does not guarantee future performance.