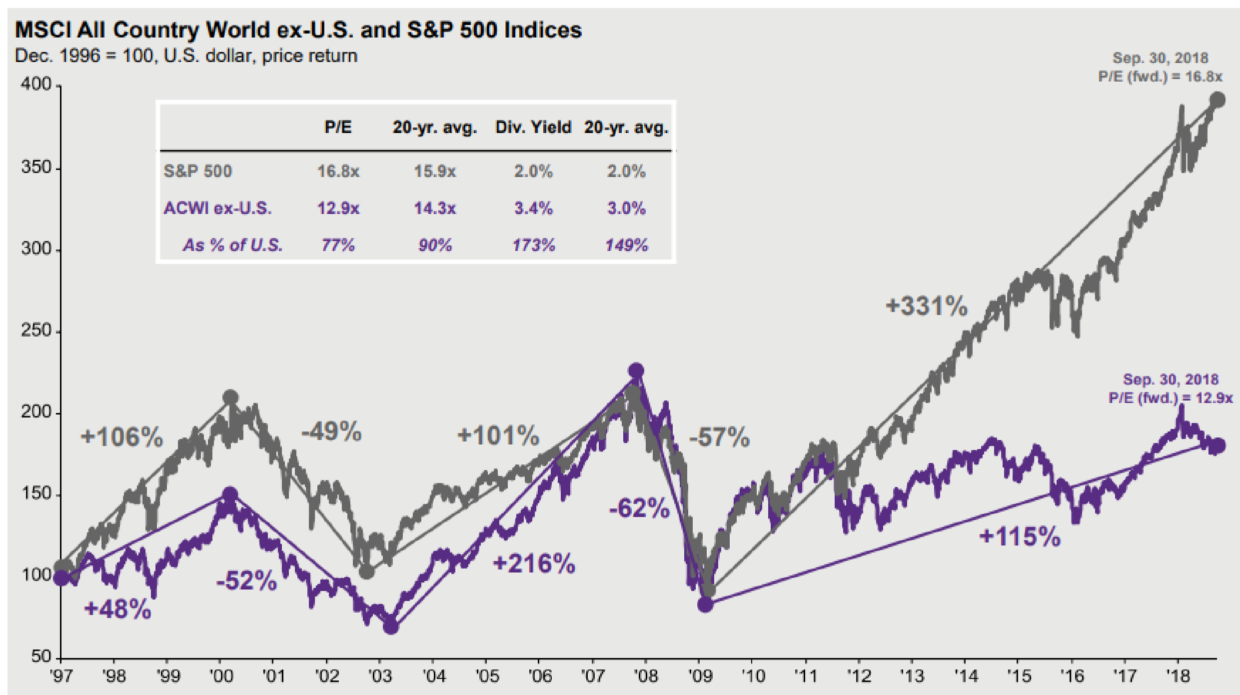
NOTTINGHAMADVISORS
ASSET MANAGEMENT

CONFESSIONS OF A GLOBAL PORTFOLIO MANAGER

Anyone familiar with the old metaphor concerning the tortoise and the hare may appreciate the challenges currently facing portfolio managers focused on “global asset allocation”. Although history has shown that globally diversified portfolios can produce better risk-adjusted returns for investors over time, there still exists periods when decidedly domestic (or international) portfolios can dominate. The period since the Great Recession is a case in point.



Source: FactSet, MSCI, Standard & Poor’s, J.P. Morgan Asset Management.

Armed with such a compelling case for domestic stocks versus international, why, you ask, have I owned anything but domestic equities the past 8 years? And, to further the armchair quarterback example, within domestic equities, why haven’t I just owned technology stocks? Or, just the FAANG names?? As with most things, hindsight can be 20/20. It’s very easy to look back and suggest a different opportunity set over a prior period of time.

As with most people, though, portfolio managers live life in real time. NO ONE KNOWS WHAT IS GOING TO HAPPEN TO MARKETS TOMORROW, NEXT WEEK, NEXT MONTH OR NEXT YEAR. That’s reality. And further to that, borrowing from John Maynard Keynes, markets can stay irrational longer than one can remain solvent! Meaning, expensive asset classes can get more expensive (before they ultimately revert to the mean), while cheap asset classes can get cheaper – before they too ultimately revert to the mean.

Nottingham Advisors constantly monitors our portfolio strategies from a risk and return standpoint, and every quarter Morningstar helps us see how we stack up against our peers. We're proud to say that our Global All-Asset and Global Balanced strategies have consistently placed in the top quartile of our peer group. Further to that, we also keep tabs on some of the largest and most popular mutual funds that pursue comparable go-anywhere type strategies. Recently, we took a look at how our two flagship portfolios stacked up over the past five years ending 9/30/18 against the Blackrock Global Allocation fund, the GMO Benchmark-Free Allocation fund and the PIMCO All-Asset fund. The results were revealing.

Fund	Return %	Std Dev	Sharpe Ratio	Up Capture %	Down Capture %
NA Global All Asset	6.97	5.64	1.13	92.5	74.0
NA Global Balanced	5.68	4.89	1.05	78.8	66.9
Blackrock Global Alloc	5.54	6.01	-0.28	87.5	86.9
GMO Benchmark-Free	3.68	5.73	-1.62	75.8	93.5
PIMCO All-Asset	3.50	6.86	-2.23	82.2	109.5

Source: Morningstar; Bloomberg; Nottingham Advisors

Nottingham's portfolios have performed exceptionally well versus larger, more popular (and more expensive!) strategies. Our annualized return rate of nearly 7% for Global All-Asset and 5.68% for Global Balanced, along with modest volatility, put our return per unit of risk (the Sharpe Ratio) far above these similarly styled funds.

We know it can be frustrating when one's portfolio isn't "keeping up with the Joneses". Investment returns, however, are best measured over long periods of time. Oftentimes, the difference between "being early" and "being wrong" isn't obvious. At Nottingham, we recognize this, but are also willing to accept the business risk of "being early" for ideas we think have merit and will play out over time.

Think back for a moment to the life of a US Value manager in the late '90's. No one wanted Value – Growth, and more specifically Tech were all one needed to own. Well, how did that work out? For the 3-year period 1997-99, the S&P 500 Growth index returned 149%, the NASDAQ returned 219% while the S&P Value index returned "just" 68%. For the 3-year period 2000-02, Growth lost -48%, Tech lost a staggering -67% while Value lost just -25%. Through the full 6-year period 1997-2002, the S&P 500 Growth index gained 29% (4.4% ann.), the NASDAQ gained 5.6% (0.9% ann.), while the S&P 500 Value index gained 25% (3.7% ann.).

The moral of the story (well illustrated by the accompanying JP Morgan "quilt chart"), is that equity investors need to maintain a long-term time horizon. Drawdowns, when they come, can be severe. The NASDAQ suffered a peak to trough decline of -76% from 2000 to 2002! The S&P 500 suffered a -52% drawdown from October of '07 to the spring of '09. Diversification matters and it comes with a cost. There is no free lunch in investing. If one wants high returns, one must take risk and know that there will be unavoidable trouble along the way.

Knowing one's own emotional limitations is crucial to successful long-term investing. If a -20% drawdown is enough to force you to sell your stocks, you probably shouldn't own them in the first place. Sell-offs can create cheap stocks, and hence opportunities. The right mind set is critical if one is to capitalize on periods when Mr. Market is a seller. And patience too is required. The Federal Reserve's Quantitative Easing program has created an environment in which, to borrow from our friends at Strategas Research Partners, "everyone gets a trophy".

There are no losers. We all know that's not how life works and most certainly not how markets work. We're reminded of Frank Borman's astute observation that "Capitalism without bankruptcy is like Christianity without hell."

Many investors we work with identify with traditional 60/40 or 70/30 stock/bond portfolios. The risk and return metrics around asset mixes like this tend to produce long-term returns in the 5-7% range, with equities returning 7-9% annually and bonds returning 3-4% annually. The return streams, however, aren't linear. Even a 60/40 portfolio suffers down years. In fact, over the past 65+ years, a portfolio of 60% S&P 500 and 40% long-term US Treasuries has suffered down years almost 20% of the time. It's unavoidable. What can be avoided is making rash decisions and focusing in on a 6 month or one year period when one's time horizon is 10, 15 or 20 years. Patience nearly always pays off.

2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	YTD	2003 - 2017 Ann.	2003 - 2017 Vol.
EM Equity 56.3%	REITs 31.6%	EM Equity 34.5%	REITs 35.1%	EM Equity 39.8%	Fixed Income 5.2%	EM Equity 79.0%	REITs 27.9%	REITs 8.3%	REITs 19.7%	Small Cap 38.8%	REITs 28.0%	REITs 2.8%	Small Cap 21.3%	EM Equity 37.8%	Small Cap 11.5%	EM Equity 12.7%	EM Equity 23.0%
Small Cap 47.3%	EM Equity 26.0%	Comdty. 21.4%	EM Equity 32.6%	Comdty. 16.2%	Cash 1.8%	High Yield 59.4%	Small Cap 26.9%	Fixed Income 7.8%	High Yield 19.6%	Large Cap 32.4%	Large Cap 13.7%	Large Cap 1.4%	High Yield 14.3%	DM Equity 25.6%	Large Cap 10.6%	Small Cap 11.2%	REITs 22.3%
DM Equity 39.2%	DM Equity 20.7%	DM Equity 14.0%	DM Equity 26.9%	DM Equity 11.6%	Asset Alloc. -25.4%	DM Equity 32.5%	EM Equity 19.2%	High Yield 3.1%	EM Equity 18.6%	DM Equity 23.3%	Fixed Income 6.0%	Fixed Income 0.5%	Large Cap 12.0%	Large Cap 21.8%	Asset Alloc. 2.9%	REITs 11.1%	Small Cap 18.8%
REITs 37.1%	Small Cap 18.3%	REITs 12.2%	Small Cap 18.4%	Asset Alloc. 7.1%	High Yield -26.9%	REITs 28.0%	Comdty. 16.8%	Large Cap 2.1%	DM Equity 17.9%	Asset Alloc. 14.9%	Asset Alloc. 5.2%	Cash 0.0%	Comdty. 11.8%	Small Cap 14.6%	REITs 1.8%	Large Cap 9.9%	Comdty. 18.8%
High Yield 32.4%	High Yield 13.2%	Asset Alloc. 8.1%	Large Cap 15.8%	Fixed Income 7.0%	Small Cap -33.8%	Small Cap 27.2%	Large Cap 15.1%	Cash 0.1%	Small Cap 16.3%	High Yield 7.3%	Small Cap 4.9%	DM Equity -0.4%	EM Equity 11.6%	Asset Alloc. 14.6%	Cash 1.3%	High Yield 9.6%	DM Equity 18.4%
Large Cap 28.7%	Asset Alloc. 12.8%	Large Cap 4.9%	Asset Alloc. 15.3%	Large Cap 5.5%	Comdty. -35.6%	Large Cap 26.5%	High Yield 14.8%	Asset Alloc. 0.7%	Large Cap 16.0%	REITs 2.9%	Cash 0.0%	Asset Alloc. -2.0%	REITs 8.6%	High Yield 10.4%	High Yield -0.6%	DM Equity 8.6%	Large Cap 14.5%
Asset Alloc. 26.3%	Large Cap 10.9%	Small Cap 4.6%	High Yield 13.7%	Cash 4.8%	Large Cap -37.0%	Asset Alloc. 25.0%	Asset Alloc. 13.3%	Small Cap -4.2%	Asset Alloc. 12.2%	Cash 0.0%	High Yield 0.0%	High Yield -2.7%	Asset Alloc. 8.3%	REITs 8.7%	DM Equity -1.0%	Asset Alloc. 8.3%	High Yield 11.3%
Comdty. 23.9%	Comdty. 9.1%	High Yield 3.6%	Cash 4.8%	High Yield 3.2%	REITs -37.7%	Comdty. 18.9%	DM Equity 8.2%	DM Equity -11.7%	Fixed Income 4.2%	Fixed Income -2.0%	EM Equity -1.8%	Small Cap -4.4%	Fixed Income 2.6%	Fixed Income 3.5%	Fixed Income -1.6%	Fixed Income 4.1%	Asset Alloc. 11.0%
Fixed Income 4.1%	Fixed Income 4.3%	Cash 3.0%	Fixed Income 4.3%	Small Cap -1.6%	DM Equity -43.1%	Fixed Income 5.9%	Fixed Income 6.5%	Comdty. -13.3%	Cash 0.1%	EM Equity -2.3%	DM Equity -4.5%	EM Equity -14.6%	DM Equity 1.5%	Comdty. 1.7%	Comdty. -2.0%	Cash 1.2%	Fixed Income 3.3%
Cash 1.0%	Cash 1.2%	Fixed Income 2.4%	Comdty. 2.1%	REITs -15.7%	EM Equity -53.2%	Cash 0.1%	Cash 0.1%	EM Equity -18.2%	Comdty. -1.1%	Comdty. -9.5%	Comdty. -17.0%	Comdty. -24.7%	Cash 0.3%	Cash 0.8%	EM Equity -7.4%	Comdty. -0.3%	Cash 0.8%

Source: Barclays, Bloomberg, FactSet, MSCI, NAREIT, Russell, Standard & Poor's, J.P. Morgan Asset Management.

Markets are going through a very tumultuous time right now. The Federal Reserve is tightening, the business cycle is nearing an end, a trade war is brewing with China, and equities are priced for perfection. We're not yet willing to call the end of the bull market, but our outlook is somewhat more cautious. It's been a good run, and there will be more "good runs" ahead. For now, investors would be well served to favor patience over action, let things settle down a bit, and keep focused on the horizon.

Larry Whistler, CFA
President/Chief Investment Officer
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