

In Investing, Defense Can Win Championships!



DeFred G Folts III
 Chief Investment Strategist
 3EDGE Asset Management
 February 2023

After a difficult year in 2022 for both stocks & bonds, this claim may be more valid than ever that when it comes to investing: DEFENSE CAN WIN CHAMPIONSHIPS!

2022 – A Challenging Year

The Financial Times aptly described 2022 as the year that ultra-low interest rates and quantitative easing died with the arrival of high inflation. By the end of last year, the S&P 500 had declined 19.5%, and the more tech-heavy NASDAQ Composite was down 33%. The high-water mark for the S&P 500 in 2022 was the first trading day of the year – January 3rd, 2022¹. What made last year even more painful for many investors was that with the onset of inflation and aggressive increases in interest rates by the Fed, bonds did not serve as a hedge against declines in equities as they have traditionally. Intermediate-term Treasury bonds (7 to 10 year maturities) lost 10.6% in 2022, the biggest decline on record for Treasuries dating to at least 1926, before which monthly Treasury data is spotty². This combination of declines in stocks and bonds made it a tough year for the traditional 60/40 portfolio. The Morningstar US Moderate Target Allocation Index – a diversified mix of 60% equities and 40% bonds designed as benchmark for a 60/40 allocation portfolio – lost 15.3% in 2022, the biggest annual decline since 2008, when it fell 22.59%³. In total, last year served to wipe out roughly \$30 trillion in investors' wealth, the heaviest losses in asset markets since the global financial crisis⁴.

The Joy of Missing Out: 3EDGE strategies were positioned defensively throughout 2022

Based on our model research, our diversified, multi-asset strategies remained at or near their minimum ranges in both equities and traditional bonds throughout 2022, as shown in Table 3 (page 2). While 3EDGE Strategies were down in 2022, they avoided the sharp declines experienced by their benchmarks and have outperformed them on a 1-year, 3-year, 5-year basis and since inception. We believe that seeking to manage volatility and portfolio drawdowns may help manage risk and can contribute to generating strong investment returns over full market cycles. Therefore, we believe that defense can win championships when it comes to investing!

Just Hang in There?

After such a challenging year, clients might be skeptical if their financial advisors try to convince them to hang in there, stay fully invested and take advantage of a market rebound which might be around the corner. The idea of "just hanging in there" is often supported by numerous examples of what could happen to an investor's portfolio if they were scared and missed out on the best days or months of market performance over an extended period. This is the familiar adage of the fear of missing out or FOMO. Not surprisingly, investment performance would not be as good if one missed out on the best months of performance over an extended period.

Table 1 below shows the difference in investment performance between the average annual return of the S&P 500 Total Return index from 12/31/1971 through 12/31/2022 and the return if an investor had missed out on the best 12 months of investment performance over the same period.

Table 1:	Average Annual Return of the S&P 500 Total Return Index	10.4%
Annualized Return for the S&P 500 Index Total Return: 12/31/1971 – 12/31/2022 <small>Source: Bloomberg</small>	Average Annual Return of the S&P 500 Total Return Index Missed the 12 Best Months of Performance	7.5%

The Other Side of *Just Hang in There* and the *Fear of Missing Out*

As Table 1 shows, if an investor didn't participate in the best periods of investment performance over an extended period, they could be disappointed with their results. It sounds good in theory to recommend that investors remain fully invested, even through periods as painful as 2022. However, as we know from behavioral finance and Daniel Kahneman's Loss Aversion or Prospect Theory⁵, this is easier said than done. It can be quite emotionally draining for investors to see their portfolio decline sharply.

So, now let's examine a different approach to investing that may be more compelling. What if, rather than focusing on the cost of missing out on the best 12 months of performance, an investor sought to avoid the worst months of market performance over an extended period? How would this impact long-term investment performance? Table 2 below illustrates that by avoiding the worst 12 months of investment returns for the S&P 500 index, an investor would have outperformed the S&P 500 by almost 3% per year on an average annual return basis from 12/31/1971 through 12/31/2022 by staying fully invested.

Table 2: Impact of Missing the Worst Months: 12/31/1971 – 12/31/2022 Source: Bloomberg	Average Annual Return of the S&P 500 Total Return Index	10.4%
	Average Annual Return of the S&P 500 Total Return Index Missed the 12 Best Months of Performance	7.5%
	Average Annual Return of the S&P 500 Total Return Index Avoided the 12 Worst Months of Performance	13.9%

We believe that the table above illustrates the potential benefits of our 3EDGE tactical approach to investing which seeks to manage risk – both volatility and portfolio drawdowns. In doing so, advisors can seek to spare their clients from the emotional distress of precipitous declines in their investment portfolios.

Our defensive positioning enabled 3EDGE's strategies to decline less than their passive benchmarks in 2022. See returns below for 3EDGE Conservative and 3EDGE Total Return strategies for 1, 3, 5-years and since inception*.

Table 3: Performance of 3EDGE Strategies *Composite performance noted in the table is updated as of 12/31/2022. Returns are shown net of actual management fees and all other expenses and includes the reinvestment of dividends and other earnings. 1 Year, 3 Year, 5 Year, and Since Inception are annualized returns based on a period of 12 months using monthly returns. See disclosures for additional information.	3EDGE Strategy Performance vs. Benchmarks*	1 Year	3 Year	5 Year	Since Inception
	3EDGE Conservative <i>Inception 1/1/2016</i>	-3.55%	3.06%	2.59%	3.51%
	S&P Target Risk Conservative Total Return	-13.99%	-0.32%	1.89%	3.45%
	3EDGE Total Return <i>Inception 1/1/2016</i>	-5.37%	5.68%	3.55%	5.48%
	S&P Target Risk Moderate Total Return	-14.41%	0.41%	2.43%	4.20%

If you would like additional information about 3EDGE Asset Management and our approach to investing, please contact us at info@3edgeam.com. You can also visit our website at www.3edgeam.com and view our weekly market analysis videos on our 3EDGE Asset Management YouTube channel.

DISCLOSURES: The opinions expressed by DeFred G. Folts III of 3EDGE are provided for informational purposes only and are subject to change without notice. They are not intended to provide personal investment advice. Investors should only seek investment advice from their individual financial adviser. Observations include information from sources 3EDGE believes to be reliable, but the accuracy of such information cannot be guaranteed. Investments including ETNs, ETFs, common stocks, fixed income and commodities involve the risk of loss that investors should be prepared to bear. Past performance may not be indicative of future results. Performance for the 3EDGE Conservative Strategy and Total Return Strategy is for the respective composites and is shown net of actual management fees and all other expenses and includes reinvestment of dividends and other earnings. The Total Return and Conservative composites' creation date is 1/1/2016.

BENCHMARKS: Conservative Strategy Benchmark is S&P Target Risk Conservative Total Return Index (Bloomberg Ticker: SPTGCMUT). Total Return Strategy Benchmark is S&P Target Risk Moderate Total Return Index (Bloomberg Ticker: SPTGMUT). 3EDGE Asset Management's investment objective is to seek to earn attractive risk-adjusted returns over full market cycles. We do not actively seek to outperform any specific benchmark index on a relative basis for the Conservative and Total Return Strategies ("the Strategies"). The Strategies are not index funds and the portfolio holdings, country exposure, portfolio characteristics and performance will differ from that of the Benchmarks. The Benchmarks are simply a baseline against which we monitor the Strategies. They are intended to represent a passive, global, multi-asset class portfolio with similar risk characteristics to the Strategies. The Benchmarks have been provided to allow for comparison of the performance of the Strategy to that of well-known and widely recognized indices. The Indices used in the Benchmarks are represented by total return prices. Indexes are unmanaged and therefore do not include fees and expenses typically associated with investments in managed accounts. One cannot invest directly in an index. Benchmark Data Source: Bloomberg.

REFERENCES: ¹ Bloomberg; ² CNBC Personal Finance, based on research by Edward McQuarrie, Professor Emeritus at Santa Clara University, January 7th 2023; ³ Morningstar Quarter End Insights, January 3rd 2023; ⁴ Stock and bond markets shed more than \$30tn in 'brutal' 2022, Financial Times, December 30th 2022; ⁵ Kahneman, D., & Tversky, A. (1979). Prospect Theory: An Analysis of Decision under Risk.