

Tactical View of Risk



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1 You run exchange-traded-fund managed portfolios. Why have they become so popular with advisors?

There are several factors, foremost among them: **cost, liquidity, and transparency.**

2 What is your strategy at Good Harbor?

It's based on the idea that aggregate investor appetite for risk changes and that there are periods when it makes sense to reduce risk in a portfolio—so, we define “tactical” as meaning **varying our exposure to market risk over time.**

3 What role does the equity risk premium play in your strategy?

We believe that going into any market drawdown, equity risk premiums rise. As we observe this rise, our model moves to a more defensive footing. We sometimes get false positives and we underperform for a time, but we have a good track record of protecting the downside.

4 What factors does your model use to measure the equity risk premium?

Broadly speaking, we look at three categories of information: **economic data, momentum indicators, and the behavior of the U.S. Treasury yield curve.**

5 What role does leverage play in your portfolios?

Unleveraged, our strategy would have a lower volatility than the S&P 500 over time. **Adding a leverage component has brought our realized volatility up to the level of the S&P while allowing us to enhance our returns.**

6 You use long-only market exposures. Why don't you use shorting strategies?

To play defense, there are three options: move to cash, go short, or buy Treasuries. **Many of our clients would have no appetite for a strategy that involved shorting equities,** and an allocation to cash gives no upside. In our research, Treasuries offer the potential of a respectable capital gain when equity markets are under pressure.

7 In June, your U.S. Tactical Core Strategy was allocated nearly 100% in Treasuries. Is your model still signaling 0% equities?

We review changes to our portfolios monthly. In May, we made a move to 100% Treasuries, and we were able to miss a sizeable correction. **By August, we were in a 50/50 allocation between equities and Treasuries, and by September, we were back to a complete equity position.** Our flexibility is as important as our discipline, and all of these moves are made within our data-driven decision framework.

8 What has the invention of ETFs meant to investors such as yourself?

In the early days, we invested in mutual funds for our index exposure. As we have grown past \$3 billion in assets, it would not have been possible for us to execute our strategy in mutual funds; they would not be able to handle our moves. ETFs can do this very well, so **our growth has been made possible by this highly efficient technology.**

9 Who has influenced your investing philosophy the most?

My partner, Neil Peplinski. He was an electrical engineer and developed the Good Harbor model in the late 1990s. It proved so successful that it prompted his engineering colleagues to beg for his help—thus was born Good Harbor.

10 You guys were classmates at the University of Chicago Booth School of Business, correct?

Yes. We both had John Cochrane. His work always originates with the concept of allowing empirical data to define relationships in markets and allowing facts to lead where they may. Professor Cochrane has the ability to make the most mind-bending concepts appear self-evident, and he instilled in us the fascination for quantitative finance.