# STRATEGY OVERVIEW

FUND ARCHITECTS
Building Momentum

FASO-0318v2

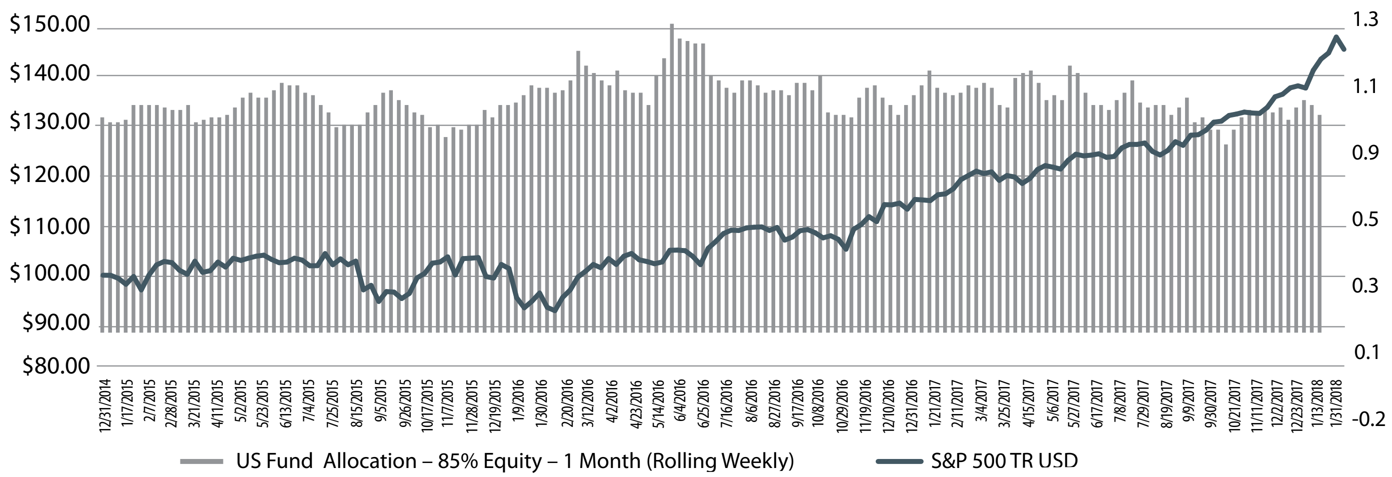
## The Secret to Adding Real Value to a Portfolio Lies in Steadily Adjusting Its Asset Allocation

Beating the benchmark is a near obsession around the investment community. But if a strategy falls 22% while its benchmark falls by 25%, are investors going to be happy? Not likely. People with money in the market are far more concerned about their absolute returns than any kind of relative performance.

Yet a prevailing investment theme these days is to label investors as either 'conservative', 'moderate' or 'aggressive' and assemble static portfolios to target their tolerance of market risk. These portfolios use long-term assumptions of risk and returns, of course — numbers that can vary wildly from short-term realities — to determine the allocation. And as we know, existing long-term averages are not indicative of future results.

The chart below shows the level of market risk as measured by its beta coefficient for the 'aggressive' category average of managers against the SP500 TR index. The gray bars' relatively constant height indicates that most managers aren't reducing risk when they believe markets are unsafe, nor are they increasing risk when markets look promising. This leads to investor anxiety during market corrections and times of increased volatility, and greatly limits the amount of value most managers can add.

**SP 500 TR vs. Category Average Beta**




*Source: Fund Architects, LLC. and Morningstar Direct. Period from 12/31/2014 through 1/31/2018. Beta is calculated using one moth data on a weekly rolling basis. Benchmark for Beta calculation is the SP500 TR. 'US Fund Allocation – 85%+ Equity' is a category average that is defined by Morningstar at http://im.mstar.com/im/newhomepage/Morningstar_Category_Definitions_US_June_2016.pdf*

### Investors can't be satisfied with this kind of active management.

We believe that the mismatch between investors' expectations and their active manager's approach is creating frustration. Evidence of this dissatisfaction can be seen from record inflows to passive mutual funds and ETFs — a trend that has been gaining speed for some time.

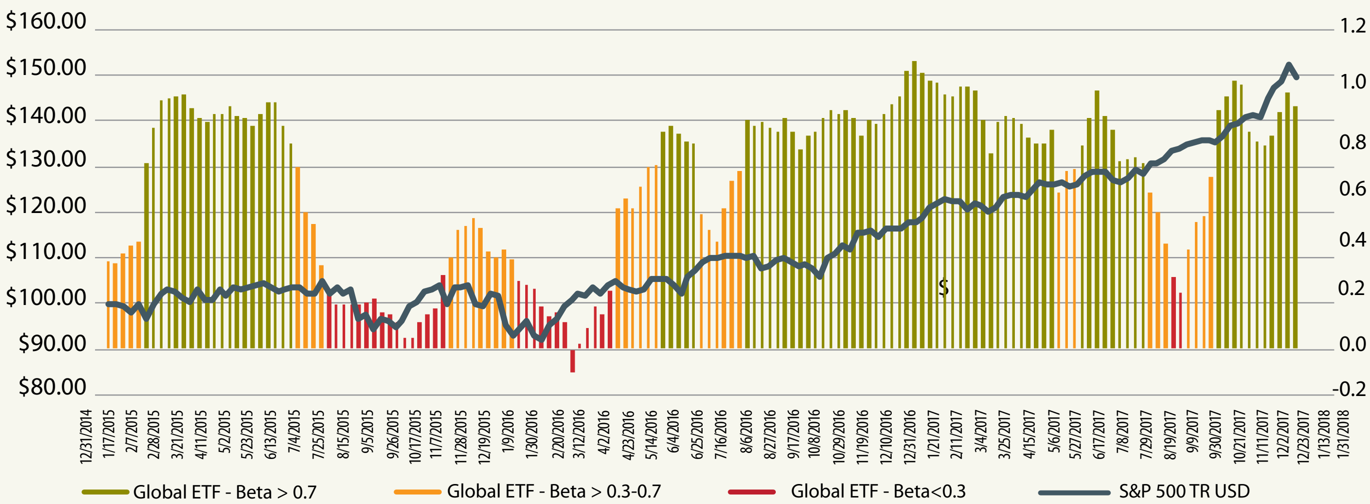
It's been shown that a portfolio's mix of stocks, bonds, and cash — its asset allocation — has the greatest impact on portfolio returns over time. Yet most managers maintain a static allocation through all market cycles. Their hope is to outperform a benchmark by individual security and sector selection.

## Managing Risk Matters

Fund Architects uses a completely different approach. We concentrate on the asset allocation, forgoing security selection altogether, in attempt to maximize our potential value add. Relying on a repeatable process that systematically adjusts the portfolio's asset allocation to the current market environment, we look to improve long-term returns by minimizing volatility and reducing losses during market corrections.

The chart below shows the beta of our Global ETF portfolio measured against the SP500 TR index. You'll notice during corrections and times of increased volatility that the Portfolio has the potential to decrease market risk (as shown in **red**). During rallies and periods of low volatility, the Portfolio can also increase the level of market risk (as shown in **green**).

### SP 500 TR vs. Global ETF Beta




*Source: Fund Architects, LLC. and Morningstar Direct. Period from 12/31/2014 through 1/31/2018. Beta is calculated using one moth data on a weekly rolling basis. Benchmark for Beta calculation is the SP500. 'Global ETF' is a Fund Architects separate account portfolio; returns are calculated by Morningstar Direct net of a 1.5% annual management fee, and not including transaction charges or other custodial charges that may apply. For illustration purposes only. Please contact Fund Architects at 866-539-4186 with questions or for additional information.*

These adjustments are made using our proprietary Multi-Factor Ranking System™, a methodical process that removes the emotion from investing.

> ***"We don't think investors are looking for a static portfolio when hiring a manager. That's why we say we're 'Building the Active Strategies Investors Expect'."***

## "Glass Box" Portfolio Construction

The Fund Architects Portfolios are built using a fully transparent management process that combines the results of the Multi-Factor Ranking System with the Investment Committee's assessment of current market opportunities.

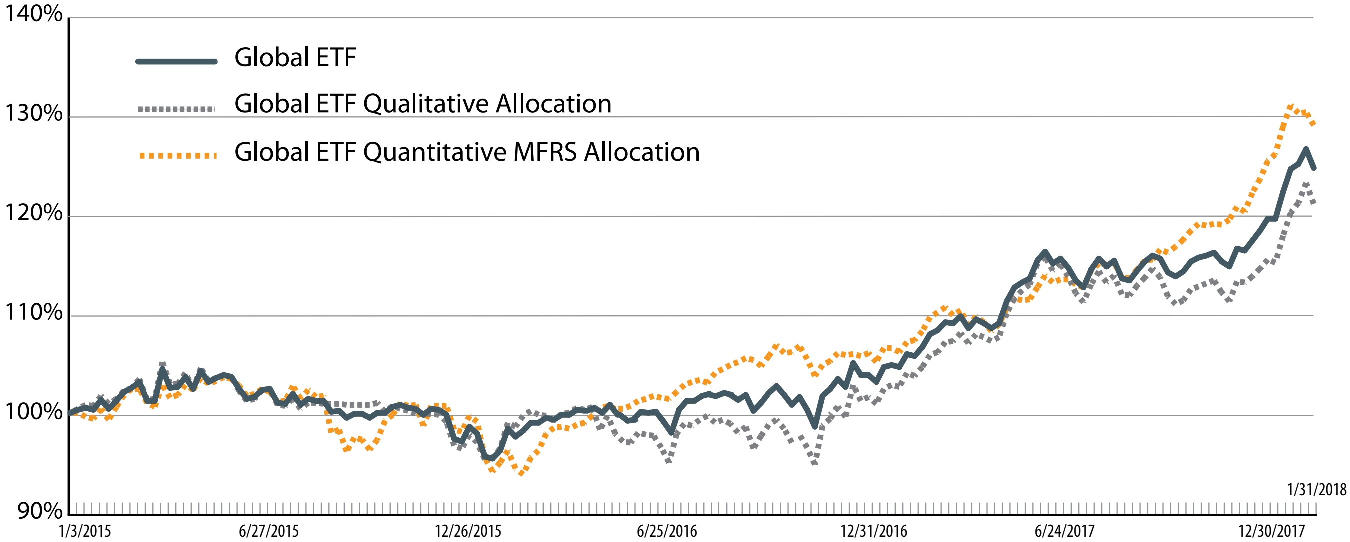
- Up to *100%* of portfolio assets are invested based on the **quantitative** results of the Multi-Factor Ranking System℠ to overweight areas of the market the system favors
- Up to *30%* of portfolio assets are invested based on a **qualitative** review of the market to provide diversification and a hedge against reversals in momentum

## What to Expect

At the first of each month, the top ranked segments as identified by the Multi-Factor Ranking System ℠ are purchased or traded for the Portfolios. Other positions in the Portfolio are chosen and managed by the Investment Committee on a continual basis. Very importantly, the Portfolios can invest completely in cash or U.S Treasuries when appropriate.

The Portfolios rely on low-cost ETFs to not only ensure the Portfolios are gaining the desired asset exposure at the lowest total cost of ownership but to eliminate manager tracking error. ETFs are an essential — and not to be overlooked — element in maximizing the risk-adjusted, after-tax, net-of-costs return for the Fund Architects Portfolios.

## Inside the Glass Box




*The chart above is calculated internally using Morningstar Direct software, and utilizes historical data for trades placed in the model portfolio. Performance data may not be representative of any individual client account as actual client account results may be lower or higher due to account specific activity The performance data shown represents past performance, which is not a guarantee of future results Investment returns and principal value will fluctuate, so that investors' shares, when sold, may be worth more or less than their original cost. No representation is made that the above performance is indicative of the experience of any one client.*

# About the Fund Architects Multi-Factor Ranking System

Our proprietary approach tracks many different global market segments in attempt to find the best investments available. And by extending our search across the globe, we're in better position to find the next bull market.

And there's almost always a bull market somewhere.

The Multi-Factor Ranking System includes a series of incremental components that, when taken together, represent a whole we believe to be greater than the sum of the parts.

1. **DEFINE the investment universe.**

   Each portfolio driven by the Multi-Factor Ranking System will track a different investment universe to achieve its objective. In the end diversification benefits don't come from the number of positions held within a portfolio, but from the correlation relationship between the positions. For that reason we look for investments that have low, or even negative, correlations to each other.

2. **RANK the investment universe.**

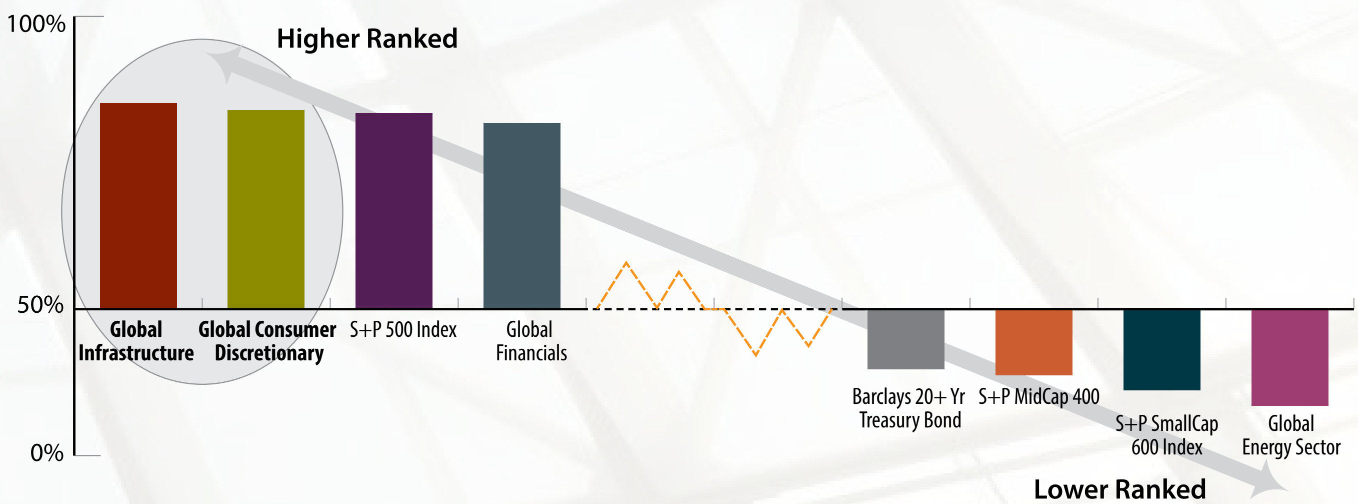
   The Multi-Factor Ranking System is primarily driven by price momentum with standard deviation a subordinate factor. Inside the ranking algorithm, price momentum accounts for about two thirds of the score.

3. **CONSTRUCT portfolio.**

   The portfolios invest in the top ranked positions, as determined by the Multi-Factor Ranking System, while avoiding the lower ranked positions altogether. This is in attempt to overweight those parts of the market viewed most favorably, and to try and add value by avoiding losers. Some portfolios may also include other positions to diversify the portfolio and help guard against reversals in momentum.

4. **REBALANCE on a monthly basis to the top ranked investments.** Our analysis indicates that the optimal holding period is one month. This period gives the momentum factor time to materialize while reducing transaction costs and portfolio turnover.

## Sample results of the Multi-Factor Ranking System




*"By extending our investment search across the globe we're hoping to find the next bull market."*

# About FUND ARCHITECTS

Fund Architects is a SEC-Registered Investment Advisor providing discretionary, fee-based money management services to financial advisors and individual investors around the country. Founded in 2007, the Firm today relies on its unique "Glass Box" Portfolio Construction process to build investment portfolios for investors seeking any combination of Capital Appreciation and Capital Preservation.

**Sources:** *https://advisors.vanguard.com/iwe/pdf/ISGGAA.pdf?cbdForceDomain=true; https://blogs.cfainstitute.org/investor/2012/02/16/setting-the-record-straight-on-asset-allocation/; https://www.cfapubs.org/doi/full/10.2469/dig.v43.n2.23*