RISK AWARE AND DOWNSIDE FOCUSED:
A New Path Forward for the Conservative Investor

By Abe Sheikh, FSA MAAA
Chief Investment Officer
and Portfolio Manager
**EXECUTIVE SUMMARY**

U.S. investors have experienced a decade of stellar performance after the Global Financial Crisis in 2008. After inflation, the S&P 500 Index returned nearly 11% a year from 2009-18, compared to the 50-year average of 5.5%. A 60% stocks / 40% bonds portfolio has returned nearly 7% a year, compared to the long-term average of 5%. In addition, these above average returns have been generated with significantly below average volatility as measured by standard deviation. Stunningly, on a risk-adjusted or Sharpe ratio basis, the experience of a U.S. investor over the last decade has been three times better than the long-term average.

Investors are rightly asking themselves: What’s next? The results of our analysis suggest scope for disappointment. A wide gap is possible between high investor expectations and an underwhelming market reality over the coming decade. For example, if current high U.S. stock market valuations compress, or if macro conditions turn unfavorable, a traditional 60/40 portfolio may return a meager sub-2% a year over the next 10 years.

Is all hope lost for those looking to protect and grow their portfolios? Our answer is an emphatic “No!” But investors must act. Our view would be to adopt an approach that is both risk-aware and downside focused and one that can help weather the possible high volatility on the horizon. At Cougar Global, we offer four mandates that cater to clients with different risk tolerance and investment objectives. Our guiding belief is that the key to achieving attractive long-term returns is to avoid large intermittent losses. In our view, investors and their financial advisors must look beyond the simple rules of the past when seeking to achieve stronger results in the future.

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1 Henceforth, “60/40”

2 Sharpe ratio is a measure of the return per unit of risk earned in a portfolio. It is calculated by dividing the excess return (over the risk-free rate) by the portfolio’s volatility.
A DECADE OF STELLAR PERFORMANCE FOR U.S. INVESTORS

U.S. stocks have experienced a decade of stellar performance after the Global Financial Crisis in 2008. As Exhibit 1 shows, after allowing for inflation, the S&P 500 Index has returned nearly 11% a year, compared to the 50-year average of 5.5%. This translates to roughly 60% more in overall portfolio value over 10 years, compared to the historical average. In addition, as Exhibit 2 shows, these above average returns have been generated with significantly below average volatility: 11.4% compared to the long-term average of 19.6%. On a risk-adjusted or Sharpe ratio basis, the experience of a U.S. stock market investor over the last decade has been almost three times better than the long-term average!

Stellar U.S. stock market performance over the last 10 years has been a boon for a traditional 60/40 portfolio. As Exhibit 3 shows, after allowing for inflation, a 60/40 portfolio has returned nearly 7% a year, compared to the long-term average of 5%. In addition, as Exhibit 4 shows, the volatility of a 60/40 portfolio over the last 10 years has been less than 6% compared to the long-term average of over 12%. On a risk-adjusted — or Sharpe ratio basis — the experience of a traditional 60/40 investor over the last decade has been over three times better than the long-term average.

3 Initial portfolio of $1 million would grow to $2.8 million at 11% per year vs. $1.7 million at 5.5% per year, or approximately 60% more.
WHAT HAPPENS OVER THE NEXT DECADE?

After 10 years of amazing risk-adjusted performance, investors are rightly asking themselves: What’s in store over the coming decade? Exhibit 5 shows four potential future scenarios for a traditional 60/40 portfolio. The results suggest scope for disappointment. For example, the difference between a “Goldilocks” scenario – which we assume to be a repeat of the last 10 years – and JPMorgan’s forward-looking expectations for a 60/40 portfolio is a whopping 5.4% per year. In dollar terms, for a portfolio with a starting value of $1 million, this translates to a difference of over $1 million or 10% of the initial assets over 10 years!

JPMorgan’s expectations may in fact turn out to be optimistic. Two other plausible scenarios we model suggest that even worst returns may be in store. For example, if current high U.S. stock market valuations compress, or if macro conditions turn unfavorable, the shortfall in value compared to a “Goldilocks” scenario could rise to $1.5 million or 150% of the initial portfolio value. Traditional investors in a 60/40 portfolio are unlikely to be happy with the meager sub-2% a year return in these two pessimistic scenarios.

So is all hope lost for those looking to protect and grow their portfolios? Our answer is “No!” As we explain in the next section, investors must recognize the possibility of mediocre returns and protect their portfolio against downside risk.

JPMorgan’s expectations use average historical return on 60/40 portfolio over falling growth/rising inflation -0.56% 1.87% Excess return assumption Risk free rate (3-month Treasuries) 25%

uses Shiller CAPE to estimate 10-year S&P 500 returns and 3-month risk free rate for Treasuries, as U.S. yield curve is Total Int’l Equity 8.50% 1.31% 10.37% 1.72% Annual return assumption JPMorgan expectations use JPMorgan’s 2019 capital market return assumptions and are calculated with 60% of the U.S Large Cap Equity arithmetic return and 40% of the 3.07% 1.87% -0.15% U.S. stock market valuations compress

Potential for disappointment)

Unfavorable macro conditions (Appendix A)

1.87% U.S. stock market valuations compress

Scenario name Risk free rate (3-month Treasuries) Excess return assumption Annual return assumption Goldilocks (last 10 years) 1.87% 8.50% 10.37%

Goldilocks (last 10 years)

JPMorgan expectations 1.87% 3.07% 4.94%

JPMorgan expectations 1.87% -0.56% 1.31%

Unfavorable macro conditions 1.87% -0.15% 1.72%

Unfavorable macro conditions Source: Cougar Global Investments. As of September 30, 2019. All investments are subject to risk. There is no assurance that any investment strategy will be successful.

PROTECTING PORTFOLIOS ON THE DOWNSIDE

Our view is that investors should adopt an approach that is both flexible and downside focused and one that can help weather the possible high volatility on the horizon. In our view, investors and their financial advisors must look beyond the simple rules of the past when seeking to achieve stronger results in the future.

At Cougar Global Investments, we have been seeking compound growth with a focus on downside risk since our founding in 1993. Our four mandates – shown in Exhibit 6 – cater to clients with different risk tolerances and investment objectives. Our guiding belief is that the key to achieving attractive long-term returns is to avoid large intermittent losses. We apply a dynamic three-step global macro-oriented asset allocation process that has a strong focus on downside risk management.

Given our current macroeconomic outlook, our portfolio is defensively positioned. As of September 30, 2019, our current stock-bond-gold allocation across our portfolios stands as follows: Conservative 10/90/0, Conservative Growth 20/80/0, Moderate Growth 45/50/5, and Growth 60/30/10 (fixed income includes cash allocation).

As tactical managers, we are able to deviate from these allocations if we believe our macroeconomic outlook warrants such a move. As new opportunities emerge or if new threats are on the horizon, Cougar Global has the ability to adjust the asset mix accordingly. We believe this flexibility and downside focus will be key in managing through the possible high volatility over the coming decade.

No matter which portfolio investors choose, they can be confident it is managed with the same guiding principles that Cougar Global Investments has followed since its beginning in 1993: a focus on capital preservation and downside risk tailored to the long-term investor’s needs and goals.

Risk Aware and Downside Focused: A New Path Forward for the Conservative Investor

Traditionally, risk-averse investors have placed a high priority on achieving attractive long-term returns while minimizing the risk of large intermittent losses. At Cougar Global Investments, we believe that in a new environment of low yields and modest expected returns, traditional risk-averse investors must focus on capital preservation and downside risk.

This strategy is based on the premise that even worse returns may be in store. Two potential scenarios we model suggest that even worst returns may be in store. For example, if current high U.S. stock market valuations compress, or if macro conditions turn unfavorable, the shortfall in value compared to a “Goldilocks” scenario could rise to $1.5 million or 150% of the initial portfolio value. Traditional investors in a 60/40 portfolio are unlikely to be happy with the meager sub-2% a year return in these two pessimistic scenarios.

So is all hope lost for those looking to protect and grow their portfolios? Our answer is “No!” As we explain in the next section, investors must recognize the possibility of mediocre returns and protect their portfolio against downside risk.

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Source: Cougar Global Investments. As of September 30, 2019. All investments are subject to risk. There is no assurance that any investment strategy will be successful.

EXHIBIT 6: COUGAR GLOBAL’S FOUR DOWNSIDE-RISK CONSTRAINED PORTFOLIOS CATER TO CLIENTS WITH DIFFERENT RISK TOLERANCES AND INVESTMENT OBJECTIVES

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Source: Cougar Global Investments. As of September 30, 2019. All investments are subject to risk. There is no assurance that any investment strategy will be successful.
APPENDIX

Appendix A: Average annual excess return on stocks, bonds and 60/40 portfolio in different economic regimes

<table>
<thead>
<tr>
<th>Economic Regime</th>
<th>Average Annual Excess Return on Stocks</th>
<th>Average Annual Excess Return on Bonds</th>
<th>Average Annual Excess Return on 60/40 Portfolio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rising Growth + Rising Inflation (11 periods)</td>
<td>5.8%</td>
<td>3.7%</td>
<td>6.4%</td>
</tr>
<tr>
<td>Rising Inflation + Falling Inflation (15 periods)</td>
<td>-3.8%</td>
<td>-1.8%</td>
<td>-2.9%</td>
</tr>
<tr>
<td>Falling Growth + Rising Inflation (16 periods)</td>
<td>14.4%</td>
<td>13.2%</td>
<td>13.8%</td>
</tr>
<tr>
<td>Falling Inflation + Falling Inflation (15 periods)</td>
<td>17.2%</td>
<td>15.1%</td>
<td>16.1%</td>
</tr>
</tbody>
</table>

Source: Cougar Global Investments. Apple, Inc. We are using Moody’s 10-Year Treasury Bond yield in a 10-Year Short Tree model for the future and the 10-Year U.S. T-bill return for historical data as of 1/1/14.

Appendix B: Actual vs. Estimated S&P 500 Total Return based on Shiller Cyclically Adjusted Price Earnings (CAPE) ratio

<table>
<thead>
<tr>
<th>Year</th>
<th>Estimated 10-Year S&amp;P 500 Total Return Based on CAPE Ratio</th>
<th>Actual 10-Year S&amp;P 500 Total Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>1937</td>
<td>-2.9%</td>
<td>-1.6%</td>
</tr>
<tr>
<td>1940</td>
<td>2.7%</td>
<td>0.0%</td>
</tr>
<tr>
<td>1943</td>
<td>-1.7%</td>
<td>2.7%</td>
</tr>
<tr>
<td>1946</td>
<td>5.6%</td>
<td>8.5%</td>
</tr>
<tr>
<td>1949</td>
<td>1.9%</td>
<td>2.7%</td>
</tr>
<tr>
<td>1952</td>
<td>14.4%</td>
<td>15.5%</td>
</tr>
<tr>
<td>1955</td>
<td>7.0%</td>
<td>11.5%</td>
</tr>
<tr>
<td>1958</td>
<td>11.6%</td>
<td>7.0%</td>
</tr>
<tr>
<td>1961</td>
<td>-0.5%</td>
<td>0.0%</td>
</tr>
<tr>
<td>1964</td>
<td>13.0%</td>
<td>12.5%</td>
</tr>
<tr>
<td>1967</td>
<td>4.2%</td>
<td>6.5%</td>
</tr>
<tr>
<td>1970</td>
<td>5.8%</td>
<td>7.0%</td>
</tr>
<tr>
<td>1973</td>
<td>14.4%</td>
<td>15.5%</td>
</tr>
<tr>
<td>1976</td>
<td>7.0%</td>
<td>11.5%</td>
</tr>
<tr>
<td>1979</td>
<td>5.8%</td>
<td>7.0%</td>
</tr>
<tr>
<td>1982</td>
<td>13.0%</td>
<td>12.5%</td>
</tr>
<tr>
<td>1985</td>
<td>7.0%</td>
<td>11.5%</td>
</tr>
<tr>
<td>1988</td>
<td>14.4%</td>
<td>15.5%</td>
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<tr>
<td>1991</td>
<td>4.2%</td>
<td>6.5%</td>
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<td>1994</td>
<td>5.8%</td>
<td>7.0%</td>
</tr>
<tr>
<td>1997</td>
<td>13.0%</td>
<td>12.5%</td>
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<tr>
<td>2000</td>
<td>7.0%</td>
<td>11.5%</td>
</tr>
<tr>
<td>2003</td>
<td>5.8%</td>
<td>7.0%</td>
</tr>
<tr>
<td>2006</td>
<td>13.0%</td>
<td>12.5%</td>
</tr>
<tr>
<td>2009</td>
<td>7.0%</td>
<td>11.5%</td>
</tr>
<tr>
<td>2012</td>
<td>5.8%</td>
<td>7.0%</td>
</tr>
<tr>
<td>2015</td>
<td>13.0%</td>
<td>12.5%</td>
</tr>
<tr>
<td>2018</td>
<td>7.0%</td>
<td>11.5%</td>
</tr>
<tr>
<td>2021</td>
<td>5.8%</td>
<td>7.0%</td>
</tr>
<tr>
<td>2024</td>
<td>13.0%</td>
<td>12.5%</td>
</tr>
<tr>
<td>2027</td>
<td>7.0%</td>
<td>11.5%</td>
</tr>
</tbody>
</table>

INVESTMENT TEAM

Abe Sheikh, FSA MAAA
Chief Investment Officer and Portfolio Manager
- 17+ years of global capital markets experience, including 11 at JPMorgan
- Publications on asset allocation and downside risk in Institutional Investor journal
- Fellow of the Society of Actuaries and Member of the American Academy of Actuaries
- Master of Computational Finance, Carnegie Mellon University
- Bachelor’s in Actuarial Sciences, London School of Economics and Political Science

Amy Steciuk, CFA
Senior Research Analyst
- 8 years of financial markets and investment experience
- Elected BSc (Honors), University of Western Ontario
- CFA Charterholder since 2014

Jason Richey, CFA
Senior Research Analyst
- 13 years of financial markets and investment experience
- Earned PhD in Math and Economics at Khazan College
- Earned MBA in Finance at the University of South Florida
- CFA Charterholder since 2004

Irina Dorogan, CIM®
Senior Research Analyst
- 9 years investment experience
- 5 years of experience in economics
- Earned Degree in Economics at Academy of Economic Studies of Moldova
Our view is that investors should adopt an approach that is both flexible and downside focused and one that can help weather the possible high volatility on the horizon.
DISCLOSURES

Risks: Certain information set forth in this presentation may contain forward-looking statements. These statements are not guarantees of future performance and undue reliance should not be placed on them. Such forward-looking statements necessarily involve known and unknown risks and uncertainties, which may cause actual performance and financial results in future periods to differ materially from any projections of future performance or result expressed or implied by such forward-looking statements. Although any forward-looking statements contained in this presentation are based upon what management believes are reasonable assumptions, there can be no assurance that forward-looking statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. Cougar Global Investments undertakes no obligation to update forward-looking statements if circumstances or management’s estimates or opinions should change except as required by applicable securities laws. The reader is cautioned not to place undue reliance on forward-looking statements.

An investment in Exchange Traded Funds (ETFs) involves the risk of losing money and should be considered as part of an overall program, not a complete investment program. An investment in ETFs involves additional risks: non-diversified, the risks of price volatility, competitive industry pressure, international political and economic developments, possible trading halts, and index tracking error. Performance is directly related to the performance of underlying ETFs and the ability of each strategy to achieve its investment objective is directly related to the ability of the underlying ETFs to meet their investment objectives.

Tactical allocation investing presents specific risks, such as currency fluctuations, differences in financial accounting standards as well as potential political and economic instability. As with all equity investing, there is the risk that an unexpected change in the market or an ETF’s holdings may have an adverse effect on its value and total return. The biggest risk of equity investing is that returns can fluctuate and investors can lose money.

Investing in small- and mid-cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor. Stocks of smaller or newer or mid-sized companies may be more likely to realize more substantial growth as well as suffer more significant losses than larger or more established issuers. Small- and mid-cap companies generally involve greater risks than investing in larger capitalization companies. They often have narrower commercial markets, more limited managerial and financial resources, and more volatile trading than larger, more established companies.

International investing involves special risks, including currency fluctuations, different financial accounting standards, and possible political and economic volatility.

Investing in emerging markets can be riskier than investing in well-established foreign markets. Emerging and developing markets may be less liquid and more volatile because they tend to reflect economic structures that are generally less diverse and mature and political systems that may be less stable than those in more developed countries.

Because these strategies normally will hold a focused portfolio of fewer holdings than many other diversified strategies, the increase or decrease of the value of a single security may have a greater impact on the total return.

There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest rates rise, fixed income prices fall and when interest rates fall, fixed income prices generally rise. Bond investors should carefully consider risks such as: interest rate risk, credit risk, liquidity risk and inflation risk.

High-yield (below investment grade) bonds are not suitable for all investors and may present greater credit risk than other bonds.

Specific sector investing such as real estate can be subject to different and greater risks than more diversified investments. Declines in the value of real estate, economic conditions, property taxes, tax laws and interest rates all present potential risks to real estate investments.

Commodities risk is the risk that investments in commodities, such as gold, or in commodity-linked instruments, will subject an underlying fund’s portfolio to volatility that may also deviate from price movements in equity and fixed income securities. Commodities trading is generally considered speculative because of the significant potential for investment loss. Among the factors that could affect the value of the fund’s investments in commodities are cyclical economic conditions, sudden political events, changes in sectors affecting a particular industry or commodity, and adverse international monetary policies. Markets for precious metals and other commodities are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

Asset allocation and diversification do not ensure a profit or protect against a loss. All investments are subject to risk. There is no assurance that any investment strategy will be successful or that any securities transaction, holdings, sectors or allocations discussed will be profitable. Strategies discussed are subject to change at any time due to market conditions or opportunities. Past performance does not guarantee or indicate future results. There is no guarantee that these investment strategies will work under all market conditions.

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The probability of negative return percentages listed do not represent a client’s actual probability of negative returns.

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- Certain information set forth in this presentation may contain forward-looking statements.
- These statements are not guarantees of future performance.
- Due to market conditions, actual results can differ from projections.
- Management’s assumptions may not be accurate.

An investment in Exchange Traded Funds (ETFs) involves:
- The risk of losing money.
- It should be part of an overall investment program, not a complete investment program.
- Additional risks such as currency fluctuations, financial accounting standards, political and economic instability.

Tactical allocation investing presents specific risks:
- Currency fluctuations.
- Differences in financial accounting standards.
- Political and economic instability.

Specific sector investing such as real estate:
- Subject to different and greater risks than more diversified investments.

Commodities risk:
- Investments in commodities like gold.
- Involves speculative nature.

Asset allocation and diversification:
- Do not ensure a profit or protect against a loss.

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