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Tuttle Tactical Management
Proven Strategies... Better Solutions

Multi-Methodology Tactical Fixed-Income Investing

Tuttle Tactical Management

Contents

Definition

Multi-Methodology Tactical Fixed-Income Investing is a tactical bond alternative method that could take a trend aggregation approach, using multiple, uncorrelated methodologies designed to earn a return similar to traditional bond holdings while also seeking to profit in the event of rising interest rates.

Fixed-Income Investing

Traditional Fixed-Income Investing is an investment strategy, generally conservative, comprised of relatively lower-to-moderate risk securities (e.g., bonds, treasuries, fixed-income mutual funds, ETFs) with the goal to preserve capital and generate investor income through forecasted, fixed interest payments until such

Fixed-Income Investing (cont.)

securities mature (after which, the principal investment is repaid to the investor). Fixed-income securities are generally considered to carry less risk than equities and may be less sensitive to some macroeconomic factors such as geopolitical events or general economic downturns. However, a few potential risks should be considered, such as interest rates, inflation, liquidity, and credit quality (in the case of corporate debt). Furthermore, each type of fixed income security will have its own different risk, so if one takes a buy-and-hold approach, one is constantly exposed to that risk.

Traditional fixed-income investing typically comprises one of two scenarios: either one is buying bonds or a bond fund to reduce the risk of an overall portfolio, or one is buying bonds or a bond fund to derive interest income. The problem with the former is that it assumes that bonds are a risk reducer to a portfolio because for the past thirty years they have been. However, it ignores the reason *why*. Bonds have been a risk reducer to a portfolio for the past thirty years because bonds move inversely to interest rates. Thirty years ago, interest rates were at 30% and now they're near zero, so bonds have been in a massive bull market. Because interest rates are near zero today, it's not possible for bonds to earn the same that they have earned in the past. Best case scenario, bonds earn a lot less interest than they have in the past. Worst case scenario, bonds become a risk enhancer to a portfolio.

Concerning the latter situation—buying bonds to earn interest—that worked when interest rates were high, but now that rates are low, for one to earn any significant amount of interest, one has to take a substantial credit risk. Considering how the bond market works, if a security yields a higher interest rate, that's because it carries more risk. One has to go off the spectrum of risk to earn any yield, risking principal in the process.

Potential Advantages

- **Capital Preservation**
- **Fixed Interest Payments**
- **A Conservative Way to Mitigate Risk**
- **Can Help Stabilize Portfolio**
- **Typically investment grade bonds are not correlated with equities**

Potential Risks

- **Interest Rates**
- **Inflation**
- **Default**
- **Liquidity**
- **Stock Market Risk (convertible bonds and high-yield bonds)**

Some Categories of Fixed-Income Securities

- **Government Agencies**
- **U.S. Treasuries**
- **Sovereign Debt**
- **Variable Rate Demand Notes**
- **Convertibles**
- **Municipal Bonds**
- **Preferred Shares**
- **Build America Bonds**
- **High-Yield Debt (aka Junk Bonds)**
- **Corporate Debt**
- **CDs**
- **Green Bonds**
- **Emerging Market Bonds**

Tactical Fixed-Income

Because both of the aforementioned traditional fixed-income strategies carry significant potential risks, and given the current state of interest rates, adopting a tactical strategy becomes a potentially attractive option. Instead of picking one or two areas of the bond market and holding them, investors can rotate among all different areas, using one tactical methodology. In this scenario one has the ability to earn money, regardless of market conditions, because one can move in and out of different sectors. But if the methodology one is using cycles out of favor, there is now a potential problem.

Enter trend aggregation. Using a multi-methodology tactical approach allows one to use multiple methodologies to move in and out of different sectors, creating a scenario that could potentially earn what bonds used to earn and still be uncorrelated with stocks in a portfolio.

Multi-Methodology Tactical Fixed-Income

As a tactical bond alternative method, multi-methodology tactical fixed-income investing can combine the agility of tactical with the added protection of incorporating multiple, uncorrelated methodologies.

Example Methodologies

Trend Following:	Buying what is going up, and selling what is going down. This methodology is based on the idea that objects in motion are more likely to stay in motion.
Intermarket Analysis:	Looking for divergences between things that move together or move apart because typically when one sees a divergence, that's a signal of a major turning point.
Pattern Recognition:	Looking for specific patterns that have tended to be predictive of moves in the past.

In a traditional tactical approach, one can shift from tech stocks, for example, to dividend stocks, but if the market is going down, the overall portfolio may still suffer losses. The idea of moving from high-yield bonds to treasury bonds, however, is entirely different. The various areas of the bond market will tend to be uncorrelated from each other. Money can move to different sectors or move to cash.

Multi-Methodologies (cont.)

Conversely, if one is using a buy-and-hold strategy, they are subject, 100% of the time, to the risk or risks in that strategy and are subject to the vagaries of the bond market. They will ride the bond market up and ride the bond market down. A tactical strategy allows for the ability to ride the bond market up but not have to ride it down. The potential downside is that if one is using a single methodology and that one methodology is wrong, the portfolio may be subject to losses.

The multi-methodology strategy shares an advantage with traditional tactical in that one can move in and out of different areas of the bond market, but utilizing multiple methodologies can help mitigate losses if one methodology cycles out of favor.

Other Potential Advantages

- This strategy can profit when interest rates go up. Traditionally, rising interest rates are red flags for bond investors, given the inverse relationship between bond prices and interest rates. When one goes up, the other goes down. If interest rates rise, bond yields may fall. Multi-Methodology Tactical Fixed-Income can adapt to rising interest rates.
- Can invest in non-traditional fixed-income ETFs and inverse treasuries.

Retirement, Dividends and Paid Interest

Historically, it might have been feasible to live off one's portfolio in retirement by collecting dividends and interest. There may be a time down the road when this becomes a more viable option, but with interest rates as low as they are, the only way one can successfully lean on this approach is by accumulating millions of dollars or, as discussed before, taking on substantial risk.

The primary goal of a multi-methodology tactical approach is not to generate dividends and interest, though it would because of the nature of the investments. But this would be, at best, a secondary goal. The primary goal of this philosophy is to earn as much as possible through dividends, interest, and capital gains, while keeping volatility fairly low. For those who are considering retirement, this strategy can be used in conjunction with creative retirement planning techniques.