Active Insights Podcast – CS McKee: Three Distinct Strategies with the Common Thread of Managing Risk and Volatility

Diane Merritt:

Welcome to North Square Investments Active Insights podcast. North Square Investments is dedicated to bringing differentiated, active investment strategies to financial advisors and investors through our multi boutique asset management platform.

Today, Mark Goodwin, Chief Executive Officer of North Square Investments will discuss the investment approach that C.S. McKee utilizes for tactical asset allocation. Brad Thompson, Portfolio Manager with C.S. McKee will provide us with his insights and outlook for the market. C.S. McKee is a partner firm in the North Square platform.

Mark and Brad, we look forward to your discussion.

Mark Goodwin:

Thanks Diane, as you mentioned at North Square, we seek out best in class active managers for our platform and our partners at C.S. McKee recently joined forces with Brad and his co-PMs from Stadion Money Management to provide additional risk managed alternative strategies to their capabilities. The Stadion Funds are now part of the North Square family of funds. Brad, thank you for joining me today.

Brad Thompson:

Thanks Mark. I appreciate it.

Mark Goodwin:

Can you give us some background on your investment team as well as the opportunity you see in joining C.S. McKee and the broader North Square platform?

Brad Thompson:

Absolutely, Mark. We have a highly experienced and talented team. Paul Frank is our lead portfolio manager on the Tactical Growth Fund. He's been running that fund since its inception and Clayton Wilkin is one of the most talented, hardworking analysts and portfolio managers I've been around in my 35 years of working in finance.

We are extremely excited about what the future holds with C.S. McKee and North Square. The added back office infrastructure and support are amazing. We're also really looking forward to seeing how the enhanced distribution efforts will work, to help provide greater investment scale. And we couldn't be more optimistic.

Mark Goodwin:

Brad, we're thrilled to have you as part of the team as well. You and your team manage three distinct strategies for us with the common thread of managing risk and volatility. The North Square Tactical Growth Fund, ticker ETFOX, the North Square Trilogy Alternative Return Fund, ticker STTIX and the North Square Tactical Defensive Fund, ticker ETFWX. Can you talk about the general portfolio strategy and objective for each of these three funds?

Brad Thompson:

Yes, happy to Mark. Really the twin hallmarks of the two tactical equity funds are their varying degrees of risk management and their ability to diversify across markets.

The Tactical Growth Fund offers more of a growth orientation while maintaining a diversified allocation with a defensive bias. For additional risk mitigation the Tactical Defensive Fund provides market exposure, but seeks to manage risks with significant and timely reductions in equity exposure, during periods of market uncertainty. The Trilogy Alternative Fund is an absolute return strategy designed to be market direction agnostic over the course of a year. And really the goal is providing stable returns, no matter which direction the equity markets have taken.

Mark Goodwin:

I'd like to take a moment to focus on the Tactical Growth strategy, which evaluates a very diverse universe of exchange-traded funds. Can you give us some background on the process to evaluate the universe of roughly 2000 ETFs to develop a workable set of potential investments?

Brad Thompson:

Sure. So we basically screen that ETF universe using a process of evaluating each ETF based on its risk adjusted performance. And we do this by analyzing each investment option based on how its near-term Sharpe Ratio compares to its longer-term Sharpe Ratio. And this gives us a clear picture of which securities are currently providing favorable risk adjusted returns. And our goal here is to identify which securities are adequately compensating us for risk, which allows us to stay away from those securities that are not currently providing adequate compensation. Then we go and we screen for liquidity, suitability and how the security may fit within the existing portfolio. And we do this to make sure that we have ample diversification within the overall allocation.

Mark Goodwin:

Can you talk about how frequently you're going through this process and what's the timeframe you're considering as you build your portfolio strategy?

Brad Thompson:

Yes, Mark, we run this process every day. However, that does not mean we're trading with that kind of frequency. We simply want to evaluate the security daily so that we can track the securities which are moving up or down within our rankings. That way there are no surprises, by that time the security is removed from the portfolio and replaced with a better risk adjusted performing security. We've seen that confirmation of the shift taking place over time via this daily analysis.

Mark Goodwin:

Digging a little deeper Brad, can you talk about how you make specific security selections and how you allocate those positions as you build the fund’s portfolio?

Brad Thompson:

Yeah, well, Mark, that's really completely driven by the data within our rankings and what we already hold in the portfolio. So we already have an existing portfolio of securities, right? So for something to be removed from the portfolio, the analysis we've been conducting daily will show it as moving down in our rankings. If the risk adjusted return profile is no longer adequate, the security is removed. That can sometimes be in favor of cash until we find a suitable replacement or more likely, it may be that a security has been rising up within our rankings and that offers similar diversification benefits, but a better current risk adjusted return profile than we may already own.

Mark Goodwin:

Can you talk about the key factors or events that might lead you to significantly change either the allocation of the fund itself for the weighting of specific securities in the portfolio?

Brad Thompson:

Yes, and again, it really boils down to our security rankings and what they look like compared to our existing portfolio. An example of a major allocation shift will be during periods of severe market stress like a 2008 environment, which most people are familiar with. Typically during times like that the Sharpe Ratios of equity based securities will decline rapidly as returns are falling and volatility rises. Also, during periods of stress like that, more defensive non-correlated securities may see improving or at least much better Sharpe Ratios. And that will oftentimes lead to a significant allocation shift out of equities into more defensive non-correlated investments.

And remember, the goal with this fund is to make sure that we stay out of the worst performing areas of the market on a risk adjusted basis profile.

Mark Goodwin:

Brad, the approach seems very flexible to me. Would you say it's fair to say that the strategy is designed to perform well over a complete market cycle, including both bear and bull markets?

Brad Thompson:

Absolutely. From our perspective, any allocation that is designed for the long-term investor should be built to do well over the full market cycle. On average, we experience a full market cycle every five to 10 years. So say for a 40 year old investor who needs to invest through retirement, which might be age 80, they will go through four to eight full market cycles. So how their investments work through the full market cycle is very important. And in reality, what the performance was yesterday, last week, last month, last quarter, or even last year is not really that important unless you plan on pulling all of your money out within those timeframes, but for investors who have 10, 20, 30, or even 40 years through retirement, we believe the full market cycle approach to investing is very prudent.

Mark Goodwin:

Much of the economy today seems to be recovering from the pandemic induced downturn and the Fed appears to be maintaining a reasonably accommodative stance, even with inflation seemingly bubbling up all around us. Where do you see the economic environment currently? And what is your broad expectation from markets over the second half of the year?

Brad Thompson:

Mark, I expect we will see continued economic recovery. I mean, businesses are having trouble hiring, which actually means business is good. And there are ample opportunities for employment. The Fed has pumped so much stimulus into the economy via their accommodative asset purchases while maintaining a low interest rate ceiling. It has created a wave of stimulus that will take some time to run through. But that being said, as you mentioned, the Fed walks a very fine line between providing stimulus and potentially overheating of the economy, which isn't good either.

That is why we've seen inflation concerns creep back into the financial markets, but it’s anyone's guess as to if the Fed has overshot or not, we will all be smarter in the fullness of time. And that is why it's so difficult to try to predict what may or may not happen.

Mark Goodwin:

How do you think this view impacts the way you position your portfolio strategies?

Brad Thompson:

Well, the good news is that what I think may or may not happen has absolutely no impact on how we make allocation decisions. All of our strategies are process-driven, which allows us to remove the guesswork and personal biases from the decision-making process. And that's by design.

Mark Goodwin:

You can look at so many ETFs as part of your Sharpe Ratio screening process and ranking process. As you sit here today, where are you finding the best opportunities for risk adjusted returns in this market?

Brad Thompson:

Well, we've recently seen a shift from growth to value and consequently added some value within our allocation. Now the question is, will that continue? U.S. equities, we continue to see them performing well. They provide adequate risk adjusted returns for the time being and the energy sector, which had been beat up pretty bad is showing some nice signs of life again. And while today isn't great for the energy sector, it's still up over 40% this year, so far. So we've added some energy to the allocation as well.

Mark Goodwin:

And generally speaking, how do you see a tactical strategy being best positioned in the diversified portfolio of an individual investor?

Brad Thompson:

Well, Mark, we see it done a few different ways, quite effectively actually. Some investors will mix a tactical strategy as an addition into their portfolio as a diversifier to their equity holdings that they already have, particularly if they feel, with markets at all-time highs that they would like to stay invested, but do so with less risk.

We also see some investors who have smaller portfolios, whether that be a retirement IRA account or just a satellite account somewhere, use it as their overall allocation because it's actually a good broad diversified allocation. And then for some sophisticated investors who have a tactical sleeve within their portfolios, it is a natural fit.

Mark Goodwin:

Very insightful Brad. Thank you. For investors who are either near retirement or are already utilizing their investment portfolios for regular income. Does a tactical growth strategy fit with those longer-term requirements to draw cash from their investments periodically, but still maintaining an attractive level of investment principal?

Brad Thompson:

Yes, we believe it's very a good alternative for investors who are taking regular income from their portfolios. We conducted an extensive research project that we have available in the form of a one-page analysis that demonstrates the impact of taking withdrawals on an inflation adjusted basis, over a full market cycle from the Tactical Growth Fund compared to passive index investing and the results are astounding. It demonstrates the real value of reduced volatility within your investment portfolio, when in the distribution phase. And Mark, we would love the opportunity to explain this to anyone that is close to entering the taking income phase of retirement.

Mark Goodwin:

Thank you, Brad. Again, thanks again for joining me today. It's been a great discussion and I really want to welcome you and the team to the broader North Square family and C.S. McKee family.

Brad Thompson:

It's a pleasure Mark, and we're excited about it.

Diane Merritt:

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The Sharpe ratio measures the excess return per unit of deviation, or risk. Correlation is a measure of how investments move in relation to one another. A correlation of 1 means the two asset classes move exactly in line with each other, while a correlation of -1 means they move in the exact opposite direction. A non-correlated asset (or security) is an asset whose value isn't tied to larger fluctuations in the traditional markets.

Diversification does not assure a profit or protect against loss in a declining market.

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