MADISON PARK
CAPITAL ADVISORS

Special Weekly Market Update

February 29, 2016

Responding to Risk

Over the past several months, regular readers of our Monday morning updates have noticed that we have been spending a fair amount of time (and words!) discussing the changing landscape of risk in equity markets around the world. The "at the end of the day" question in all of this has been whether these churning data points would necessitate major changes to investment allocations. Today we deviate from our regularly scheduled programming – as this changing landscape has now led us to a signficant shift in the risk profiles of our recommended client portfolios. Rather than digging into data points from the financial markets, please indulge us as we look at our process and the resulting changes we are making today for clients of MPCA.

We believe risk assessment is of the utmost importance, especially in determining the appropriate tactical asset allocation in our recommended client portfolios. For practical purposes, one way to define tactical asset allocation is simply our recommended exposure to risk assets (mainly but not limited to equities) in our portfolio models at any given point in time. Specifically, we have been waving some "caution flags" as the indicators that we rely on have pointed to elevated probabilities of further downside risk in the equity markets.

It is our conviction that typical and periodic corrections of 10-15% must be endured in longer term portfolios to achieve expected levels of return sufficient to meet the needs of most investors' financial plans. That being said, we are not willing to endure the more catastrophic downside risk that accompanies severe cyclical bear markets such as was experienced in 2000-2002 and 2007-2009.

Over the past several months, in response to the heightened downside risk mentioned above, we have gradually reduced exposure to equities in our portfolio models, although not in a dramatic way up until now. However, with the persistent and continuing deterioration in the risk landscape since the major equity markets around the world peaked last spring, that is about to change.

Today, as part of our monthly decision-making discipline, and in response to

careful daily monitoring of a robust and comprehensive matrix of inputs, we have undertaken a significant "de-risking" of MPCA client portfolios across all risk tolerances. Our goal, as always, is to increase the likelihood of avoiding major downside market risk without sacrificing our ability to capture a significant percentage of upside moves as well.

In the jargon of portfolio management, our process strives for the best possible combination of low "downside capture" and high "upside capture." Unfortunately, and as readers can no doubt understand, perfection in this pursuit is not attainable. In the words of Michael J Fox, "I am careful not to confuse excellence with perfection. Excellence I can reach for; perfection is God's business." At the present moment, our assessment is that, based on decades of market history, probabilities are high for downside risk, and we must respect that.

If future events prove us "wrong" and the markets begin a broad-based rally from these levels, we will respect that message as well and adjust portfolios accordingly. We do not expect a major uptrend to begin at this point in time, however, and our indicators have a pretty good track record of getting those major moves right. The best we can do is to respond decisively when probabilities are high for major market moves, one way or the other.

This decision springs from our steadfast commitment to a "rules-based" decision-making process that attempts to remove destructive emotions of fear and greed from the investment equation. Trust us, in almost 50 years of combined experience, we have witnessed firsthand the negative consequences of investors being on the wrong side of behavioral economics in both up and down market cycles. We also know, and freely acknowledge, that the advisors to those investors are not immune from the harmful effects of destructive emotions either. For that reason, we strive to remove them from the equation.

As always, our commitment is to transparency in our decision-making and to communicating the rationale for those decisions as consistently and as clearly as possible. In the same manner, we invite and welcome your thoughts, comments, and questions.

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