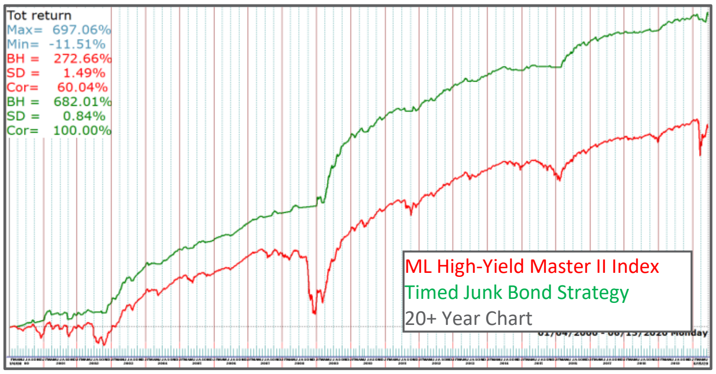
RGB Perspectives

June 15, 2020

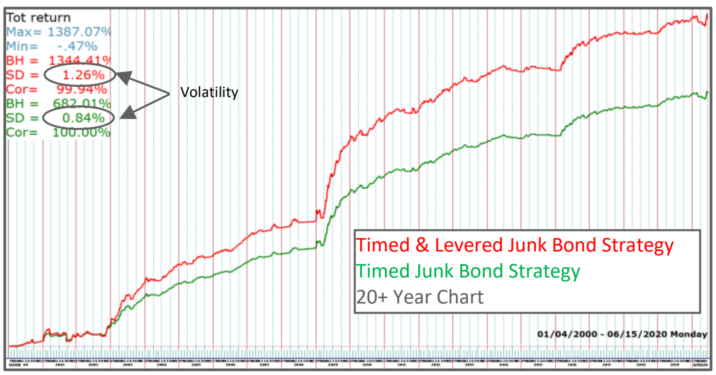
Written by Rob Bernstein (rob@rgbcapitalgroup.com)

RGB Capital Group LLC • 858-367-5200 • www.rgbcapitalgroup.com

Recently, I received a few questions about our use of leverage in our Core Non-Qualified (CN) and Balanced Non-Qualified (BN) strategies. I thought an explanation of how leverage on a low volatility portfolio can increase our exposure to the market while maintaining overall volatility signficantly below that of the equity market. My preference is to use margin (a type of leverage) which is borrowing money from our custodian and using those funds to invest in additional low volatility mutual funds. Clients benefit from any capital gains (or suffer any losses) and pay interest for the use of those funds.

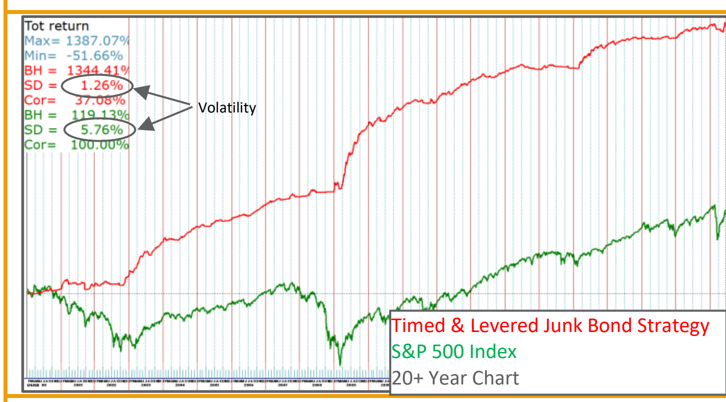


To help explain the concept of using margin on a low volatility portoflio, it is important to understand the value of moving average timing. The ML High-Yield Master II Index (junk bond index) is an example of a low volatility asset class. Owning junk bonds when they are trending above their 50-day moving average and selling junk bonds when they are below their 50-day moving average results in the Timed Junk Bond strategy. This type of strategy has historically avoided large, life-altering declines including the most recent decline as a result of the coronavirus pandemic.



By using 100% of an investor's equity and 50% of that amount borrowed from our custodian, you can invest 150% into the Timed Junk Bond Strategy. Assuming a 4% interest rate, this results in the Timed & Levered Junk Bond Strategy which has a higher overall return than the Timed Junk Bond Strategy (14.0% vs 10.6% annualized).

While the return is higher, the overall volatility is also higher, but not significantly so. The volatility of the Timed Junk Bond Strategy, as measured by standard deviation, is 0.84% vs. 1.26% for the Timed & Levered Junk Bond Strategy.



To put this level of volatility into perspective, the volatility of the Timed & Levered Junk Bond Strategy is significantly less than that of the S&P 500 Index. In fact, over the last twenty years, this strategy of selectively using margin has provided better risk-adjusted returns by increasing returns (14.0% vs. 3.9% annualized) while maintaining volatility to less than ¼ that of the S&P 500 (1.26% vs. 5.76%)!

The RGB Core Non-Qualified and Balanced Non-Qualified strategies are currently using margin to take advantage of the low volatility trends that are available. The Qualified versions of these strategies are precluded from using margin as it would create a taxable situation in our tax-deferred or tax-free retirement accounts.

I have made no changes to the investment strategies over the last week and all strategies remain fully invested. Volatility has picked up recently but not enough to create changes to our strategies. I continue to monitor the market and will make adjustments, when necessary. Thanks for your continued trust.

Prepared with data through 6/15/2020