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The Meta Strategy ETF Portfolio

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Dear Subscriber,

Wow, what a month!
It is already one for the history books due to the stock market´s unprecedentedly fast crash into a bear market environment as well as the largest 3-day recovery in over 90 years.

The Meta Strategy has definitely been crash tested now and I wrote a detailed article about how this played out.
The conclusion: the strategy worked very well in constraining portfolio losses in two stages. Overall the drawdown from all-time highs was -16% - less than half of the S&P 500, which has posted a maximum drawdown of -35% so far. Because of the delay from signal to publication, the newsletter sell dates even reduced that drawdown to -11%, when the strategy´s model portfolios went to 100% cash on March 10th 2020. This month alone the S&P 500 ETF SPY lost almost 20% (from March 3rd to April 5th - the newsletter publication dates), whereas the defensive ETF portfolio was only 50% invested in stocks at the beginning of the month and exited completely on the 10th, which limited the loss to -4%.
For the aggressive ETF portfolio (designed to use leverage for higher returns combined with maximum drawdown expectations in-line with the overall stock market) the protection of a tactical strategy is even more important as leveraged losses can add up very quickly. The strategy limited losses to -24% (well below the market´s maximum drawdown of -35%) which it can quickly make up for during the next bull market. Unprotected leveraged exposure to the S&P 500, on the other hand, would have been down -61% at the March 23rd lows - a devastating drawdown.

The speed of the decline has made it very hard to follow these signals however and investor psychology is an often overlooked point when implementing systematic signals manually: *the strategy is only as good as the investor following it*.
It is very difficult to exit during a drawdown – the urge to „wait for a bounce“ is extraordinarily strong as we anchor to the portfolio highs we saw just a week or two prior.
For anyone who fell into this trap (I can assure you: you are not the only one) or missed the intra-month update: now is a good time to rotate to cash as stock prices have recovered to a level that is not far below the exit signal on March 9th.

The future is extremely uncertain now and sitting in cash gives the optionality to wait for the big picture to clear up. The „worst“ that can happen is, that we experience a quick recovery and the re-enty signal into the stock market is signaled at higher prices than our exit. Such a short bear market has never happened before and chances are high, that it will take some time to work through the psychological and economic impacts of the Coronavirus crisis - a process which may very well lead to lower stock prices in the coming months.

A systematic strategy avoids the common problem of failing to re-enter the markets after a panic sale in a bear market and missing a large part of future gains.

I hope you are weathering the crisis safely!

sincerely
David Steets

Portfolio changes

Defensive ETF portfolio	100% cash
Aggressive ETF portfolio	100% cash

Background

The Meta Strategy uses systematic fundamental and technical inputs to gradually rotate a portfolio between different asset classes according to market conditions. It is invested in stocks by default, because they return more than other financial assets (for example bonds, real estate or commodities) over the long term. A traffic light model, that judges the health of the economy and the stock market, determines how much of the portfolio is allocated to these risky assets and when to move to safe or alternative assets to protect against the risk of losses.

Find out more details about the Meta Strategy here (oder hier auf deutsch).

I run two model portfolios suited either for normal or more aggressive investors. Both portfolios use the same signals, but invest in different exchange traded funds (ETF) that cover broad markets.

Defensive ETF portfolio characteristics	long only
Aggressive ETF portfolio characteristics	leveraged long and short

The defensive portfolio aims to earn the same return as the stock market, but with only half the maximum losses from the peaks over the long term.
The aggressive portfolio, for investors who can stomach the risk of drawdowns as high as we have seen in the stock market in the past as well as higher short-term fluctuations, aims for returns that beat the stock market over the long term.
Using leveraged ETF will magnify the daily move of the underlying index by the leverage factor. Short (or inverse) ETF will return the opposite of the index every day - this causes a rise in the value of the fund in a falling market and allows us to profit in prolonged bear markets.

Scroll down to the bottom of the newsletter to see the returns of the model portfolios since inception and a historical performance backtest.

Current indicator status

What does the current market environment tell us?

Fundamental indicators	red warning since April 2020
Technical indicators	Stop Loss signaled risk reduction on 28.2.2020 and triggered exit to cash on 9.3.2020

Systematic indicators based on the price of the the US stock market and the state of the US economy, as the dominant driver of asset prices worldwide, define my assessment of the market environment. See here for detailed rules on how these indicators are used to generate the current status. (a password for access to exclusive content was sent to you when you subscribed to this service).

Thoughts on the market environment

February 2020 already saw the stock market plunge unprecedentedly quickly into correction territory, but March managed to top that development by a wide margin. We are now in a clear bear market environment as signaled by the fundamental and technical indicators of the Meta Strategy and we have reached this stage faster than ever before with hardly any advance warning. Overall the market´s volatility (and this includes bonds and commodities) shot up to the highest levels we have ever seen - with the only remaining comparable periods in the last 100 years: The Great Depression 1929 - 1933, Black Monday 1987 and The Great Financial Crisis 2008 - 2009.

Future uncertainty is high as nobody can forecast the trajectory of the Coronavirus crisis with any degree of accuracy - not to speak of the economic consequences and possible second order negative cascades or positive innovative reactions to the crisis. Nobody knows and the Meta Strategy has now rotated completely out of risky assets into cash until the big picture clears up. I monitor safe and alternative assets as well as stocks, but both bond and gold volatility are so high, that this prohibits the strategy from buying either asset class at the moment. The current environment favors gold which is top of the list as a buy should we transition into a longer bear market for equities.

The Meta Strategy signals:

The only active fundamental warning signal going into the crash was the inversion of the US treasury yield curve (10-year vs. 3-month treasuries) in the summer of 2019 and again in February 2020. This inversion has proven once again to be one of the most reliable signs of trouble brewing in the economy with a very useful lead time of several months.
For all other fundamental indicators the development of the Coronavirus crisis happened too fast and we have seen first warning signals in key indicators only during the last week or two - too late to be of much use. The silver lining here is that all indicators pointed to a solid economic environment before the shock which indicates the possibility of a quick recovery, if more permanent economic damage can be avoided.

On the technical side things look very different: a strong warning signal was triggered as early as February 27th by the inversion of the VIX Futures Term Structure - a sign of a volatility regime change, that often foreshadows choppy, volatile market conditions over several months. The second ingredient was the breach of the long-term trend (measured by the 275- day moving average). Despite the speed of the decline, these signals managed to signal an exit from equities in two stages well within the expectations for the Meta Strategy. Volatility signals were especially helpful as the volatile crash caused an early warning, whereas technical trend-following signals tend to work better in a slower decline. For example, the strategy's strongest trend signal (when the 60- day moving average crosses below the 275- day moving average) will only trigger sometime next week.

The Meta Strategy's signal to re-enter the stock market will be the reverse - a golden cross (when the 60- day moving average crosses back above the 275- day moving average). The relative slowness of this signal ensures that the possibility of getting trapped in a fake bear market rally is quite small, but it historically still triggers well before we will see fundamental indicators recovering - most of the time the stock market anticipates a stabilizing economy early on.

Outlook

Last month´s hypothesis about the end of this bull market played out in time-lapse speed - much faster than anyone anticipated.
I still think the process of laying out the highest probability scenarios is a good method in the long run as betting on a course of events that has no historical precedent is bound to fail the majority of the time. It is better to have safeguards in place to deal with a worst case scenario (the strategy's technical stop loss signal), but expect an outcome showing parallels to historic events - the majority of time the world is chugging along quite regularly.

Because the picture has changed completely in record time, we have to re-write our expectations from scratch (again looking at historic similarities):

- Big Picture: two major scenarios that are now possible, but historical cases are skewed towards a quick recovery following the basic long-term economic growth trajectory - the economy often proves to be more resilient than anticipated especially after exogenous shocks.
  - 1) Bear Case: The coronavirus shock speeds up the usually drawn out top of a long bull market and this crash cascades into a longer economic recession and a severe bear market of -40% to -60% (playbooks: 1929, 1937, 1973, 2000 Nasdaq, 2007)
  - 2) Bull Case: The coronavirus impact is strong, but can be contained and economic consequences are temporary. Enormous monetary and fiscal stimulus acts like rocket fuel to propel economic growth and we bounce back quickly (playbooks: 1970, 1980, 1987, 1990, 1998, 2001, 2010, 2011, 2015/16, 2018)
  - In both cases the short- to medium-term has a high probability to play out similarly: we see

    a very volatile claw-back over several months with higher prices over the next 3 to 6 months accompanied by strong pullbacks (new lows in the meantime are not unlikely). V-bottoms that go straight back up are rather rare, but they do happen about 20% of the time.
  - A decisive point is often reached at the medium- to long-term trend (60- to 275- day moving average) when the rally turns out to be a bear market rally followed by new lows or alternatively is a sustainable recovery which triggers a golden cross entry signal a short time later.

Aggressive ETF Portfolio alternatives

For investors, who want to be more nimble and proactive, the Meta Strategy has two extra systematic possibilities for its aggressive portfolio:

- It may use inverse ETF, that gain when the market falls. The entry condition will be fulfilled during the next week when the 60- day moving average crosses below the 275- day moving average. Alternatively it would be possible to follow the big picture scenario and wait for an entry whenever the first bear market rally plays out (short entry between the 60 to 275- day moving averages) - this would reduce risk as the worst case exit point for a short position would be the next golden cross re-entry into long positions.
- Conversely there is an additional contrarian entry rule, if we see new lows first. It targets overstretched bear market conditions when the S&P 500 falls -25% below its 275-day moving average (currently near the March lows at 2200) and enters a regular or 2x leveraged S&P 500 ETF. This has a good chance for outsized profits even during bear market rallies, but it is important to note that the position is unprotected and just rides out the remaining downside - a tactic that was very difficult to stomach during the Great Depression (however no more so than buy-and-hold), but has been quite successful ever since.

Here you can find a comprehensive list of fundamental and technical indicators used in the Meta Strategy model, including a list showing their warning signal triggers.

Current asset class selection

Asset Class	Portfolio allocation
Risky assets: stocks	0%
Safe assets: bonds	0%
Alternative assets: gold	0% - possible entry soon
Cash	100% Cash
Aggressive assets: short stocks	0% (aggressive portfolio only) - possible entry soon

Why did I select these asset classes?

The Meta Strategy signaled a Stop Loss to exit all equities on March 9th 2020. It stays in cash for the moment, because other asset classes are extremely volatile. If volatility dies down and stocks continue to fall, gold is the preferred asset. Alternatively stocks can be re-entered when we see a golden cross (when the 60- day moving average crosses back above the 275- day moving average).

The aggressive ETF portfolio has the additional possibility for a short entry or a contrarian long entry in the near future (details see: Thoughts on the market environment / Aggressive ETF Portfolio alternatives).

Find the systematic rules governing the asset allocation in the model portfolios here.

Current portfolio

Defensive ETF portfolio	100% cash
Aggressive ETF portfolio	100% cash

The percentage numbers describe the invested portion of the capital that is allocated to the model portfolio as a whole.

List of ETF

Current regulations prohibit Eurozone investors from buying US based exchange traded funds (ETF), but they can choose EU equivalents. Several choices are usually available and I only list one possibility here. Best practice is to select the cheapest, most liquid ETF available.

US ETF	S&P500: SPY or SSO (2x leveraged). Short ETF: SH Euro STOXX 50: FEZ or FFEU (2x leveraged) Gold: GLD
EU ETF	S&P500: iShares Core S&P 500, IUSA, ISIN IE0031442068 or Xtrackers S&P 500 2x Leveraged Daily Swap, DBPG; ISIN LU0411078552 (2x leveraged). Short ETF: Xtrackers S&P 500 Inverse Daily Swap, DXS3, ISIN LU0322251520

	Euro STOXX 50: Invesco Markets plc-EURO STOXX 50, SC0D, ISIN IE00B60SWX25 or Lyxor EURO STOXX 50 Daily (2x) Leveraged, LVE, ISIN FR0010468983 (2x leveraged) Gold: iShares Physical Gold ETC, PPFB, ISIN IE00B4ND3602

Portfolio performance

Monthly returns of the two model portfolios are tracked in real time since January 2019 (this is not a backtest). I invest my own money in the aggressive ETF portfolio.
New positions are entered at the daily closing price one day after the newsletter´s publication. The usual publication date is the 5th of each month, but exits may be triggered intra-month and are communicated via irregular newsletter updates.

Defensive ETF Portfolio													
Return	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2019	0,00%	0,00%	1,03%	0,14%	-3,42%	4,86%	-3,49%	1,89%	-1,05%	5,91%	0,56%	3,21%	9,57%
2020	0,07%	-7,07%	-3,98%										-10,71%

Aggressive ETF Portfolio													
Return	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2019	0,00%	0,00%	1,03%	0,88%	-6,49%	10,86%	-6,74%	3,05%	-2,32%	11,44%	0,22%	7,95%	19,58%
2020	0,87%	-16,13%	-7,97%										-22,14%

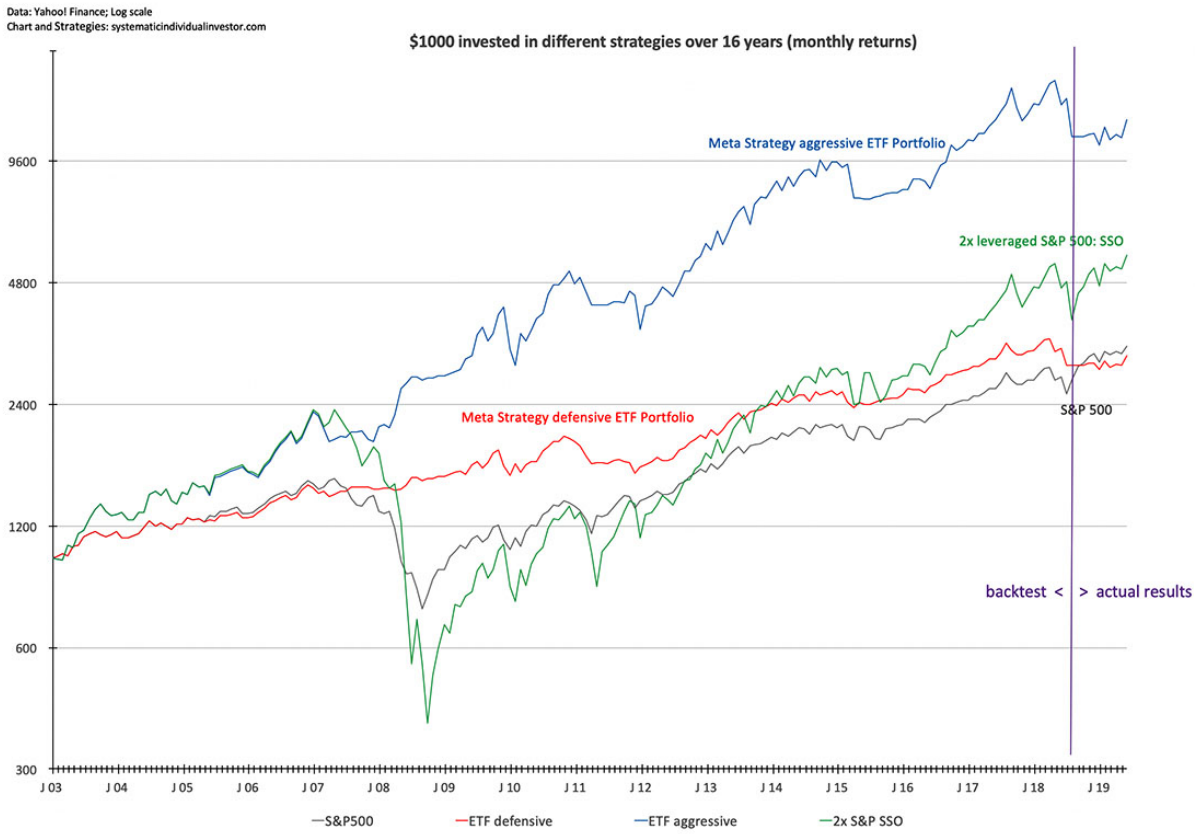
Portfolio performance assumes no commissions which is realistic for some US discount brokers. Transaction costs are higher at EU brokers and traditional banks.
The model portfolios are not currency hedged. I use US ETF to track performance in US$. Depending on the investor´s location currency fluctuations have an impact, that tends to equal out over time.

Position history

Date	Defensive Portfolio	Aggressive Portfolio
06.01.19	cash	cash
06.02.19	cash	cash
06.03.19	bonds, gold	bonds, gold
06.04.19	US stocks, gold	2x leveraged US stocks, gold
06.05.19	US stocks, EU stocks	2x leveraged US stocks, 2x leveraged EU stocks
06.06.19	US stocks, EU stocks	2x leveraged US stocks, 2x

		leveraged EU stocks
06.07.19	US stocks, EU stocks	2x leveraged US stocks, 2x leveraged EU stocks
06.08.19	US stocks, EU stocks	2x leveraged US stocks, 2x leveraged EU stocks
06.09.19	US stocks, EU stocks	2x leveraged US stocks, 2x leveraged EU stocks
06.10.19	US stocks, EU stocks	2x leveraged US stocks, 2x leveraged EU stocks
06.11.19	US stocks, EU stocks	2x leveraged US stocks, 2x leveraged EU stocks
06.12.19	US stocks, EU stocks	2x leveraged US stocks, 2x leveraged EU stocks
06.01.20	US stocks, EU stocks	2x leveraged US stocks, 2x leveraged EU stocks
06.02.20	US stocks, EU stocks	2x leveraged US stocks, 2x leveraged EU stocks
04.03.20	50% US & EU stocks	US stocks, EU stocks
10.03.20	cash	cash

Historical performance backtest



A 15-year backtest, followed by one year of actual investment performance, (06-2003 to 10-2019) of the Meta Strategy Defensive (red) and Aggressive (blue) ETF Portfolios shows the advantages over buy-and-hold portfolios distinctly: Losses in the worst bear markets were reduced, while overall returns were improved in the defensive ETF portfolio. Throughout the backtest the defensive strategy earned about 1% more annually than an investment in the S&P 500 (grey) and the ride was a lot smoother, avoiding the sleepless nights of 2008/09.

These lower drawdowns make a responsible use of leveraged and inverse ETF possible. The aggressive strategy (blue) more than doubled the annual return of an investment in the S&P 500 in the backtest with fewer than two allocation changes per year on average – 16,70% vs 6,73% annually leading to 3,6x more money earned over the 15 year backtest period (not including dividends or transaction costs).
For comparison I included the performance of a buy and hold investment in a 2x leveraged S&P 500 ETF (green). Here the lethal volatility of untamed leverage becomes apparent: an 83% drawdown in 2008/09, but an outperformance over the S&P 500 over the whole backtest period nonetheless.

Investors seeking a different return / risk profile from the model portfolios can simply mix them with a safe, short-duration treasury bond ETF.
For example, the Meta Strategy Defensive ETF portfolio can be expected to lose around 25% from its highs occasionally (in extreme circumstances, e.g. the crash of 1987, losses might even be worse) - half the maximum drawdown of the stock market. Investing only half of the available capital in the portfolio will bring the maximum drawdown down to around -12,5%, but can be expected to yield only half the return of the stock market. The same principle works to dilute the Meta Strategy Aggressive ETF portfolio to yield returns and drawdowns between the defensive and the aggressive portfolios.

Backtested results are hypothetical and NOT an indicator of future performance.

Disclaimer

This letter is a description of my own investment approach and ideas and I personally invest in the aggressive ETF portfolio. The content of this letter is for entertainment purposes only and not meant to be investment advice to others.

I am not an investment advisor and I do not provide individual investment advice. None of the ideas in this letter are meant to be construed as professional financial advice.

Your investment decisions are solely your own responsibility and I am not legally or financially responsible for any losses you may incur from reading or using the content on this letter.

All backtested results are hypothetical and NOT an indicator of future performance.