CLOTHIER SPRINGS
Capital Management

PremiumPoints

Timeless Truths. New Perspectives.

Welcome Back...to the second edition of the new PremiumPoints.

When it comes to investing, we believe in a few Timeless and unassailable Truths here at Clothier Springs Capital Management. The first is that costs matter. Investors earn net returns after costs. Unlike the uncontrollable and unforeseeable random and volatile price action of the markets, controlling costs is the surest path for investors to improve their net returns.

Investors are catching on. Morningstar reports that over the past decade, 95% of all mutual fund flows have gone into funds in the lowest-cost quintile. Fund families with lower asset-weighted expense ratios—most notably Vanguard—have gained market share.

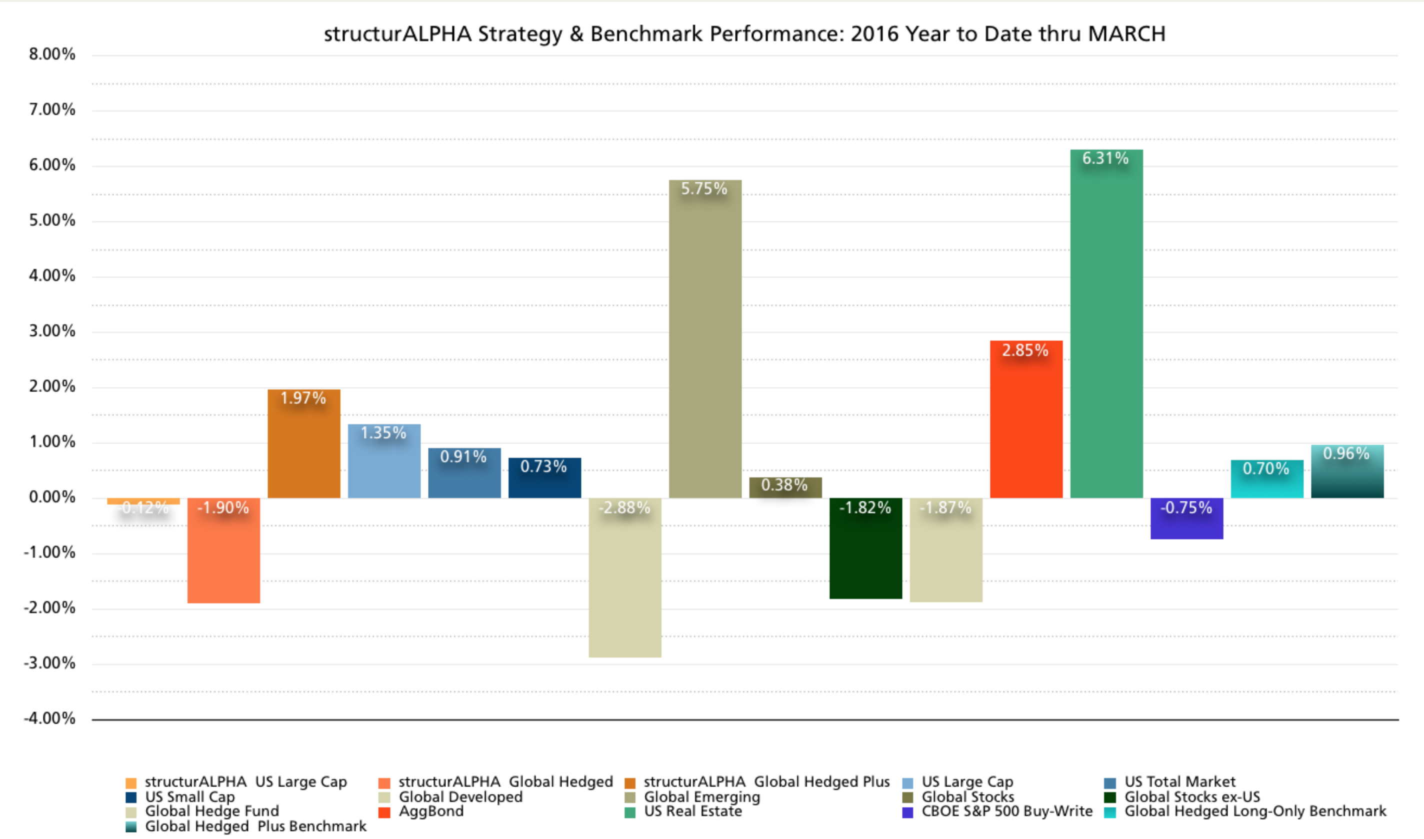
This does not necessarily mean that all investors are reaping the benefits of lower fees. Many investors also pay an investment advisor to organize and supervise their investment program. These fees are usually 1.0% annually or higher. The bias of many advisors is to try to justify their hefty fee layer by manufacturing strategies that seek to earn excess returns through the active selection of securities or asset classes. We see a great deal of these product solicitations here at CSCM. Most of them do not pass muster. We offer one example in this issue.

The financial services sector has grown from 6.0% of the S&P 500 in 1979 to 16.4% at the end of 2015—a nearly three-fold increase. So even though mutual fund fees have been under pressure, the financial services sector has found numerous other ways to enrich themselves: fees, transaction costs, proprietary trading, etc. And don't get us started on hedge funds, the perfect vehicle to shear the client-sheep.

But with the tremendous growth of the Exchange Traded Fund (ETF) market, investors now have more low-cost, transparent and liquid global markets to access. This is an absolute good thing for investors, and goes a long way towards explaining why ETFs appear poised to rule the investing world.

About Clothier Springs Capital Management, LLC

We help investors improve outcomes and meet their objectives with greater certainty and less risk with *structur*ALPHA™—our suite of Managed ETF strategies that combine the well-known cost and market capture advantages of passive investing with the superior return and risk profiles of a structurally implemented, rules-based hedge.



Review & Outlook

The global equity markets staged a strong rally from the late-January early-February lows. The bellwether S&P 500 gained almost 14% from the market low of February 11th. Still, for the quarter, the S&P 500 earned a total return of just 1.35%. A modest return to be sure but It felt like a victory. The MSCI Emerging Markets index gained roughly 20% from its low on January 20th, and for the quarter gained almost 6.0%. The global benchmark—the MSCI All-Country World Index—gained 13.0% from its low and through the end of the quarter was in positive territory by a mere 0.4%.

The markets have continued to rally so far in April, perhaps prompted by some constructive comments by Federal Reserve Chairman Yellen about potential interest rate hikes. Whatever the reason, the markets cheered and the rally continues.

Investors were rattled with the sharp sell-off early in 2016 and we at Clothier Springs are not immune to gloomy, media-driven sentiment. The 24/7 news cycle demands comment on every data-point and market hiccup, and try as we might, media alarms and client angst do ultimately register. We invest to make money for our clients and when markets are under pressure over the short-term, we can all be a little spooked.

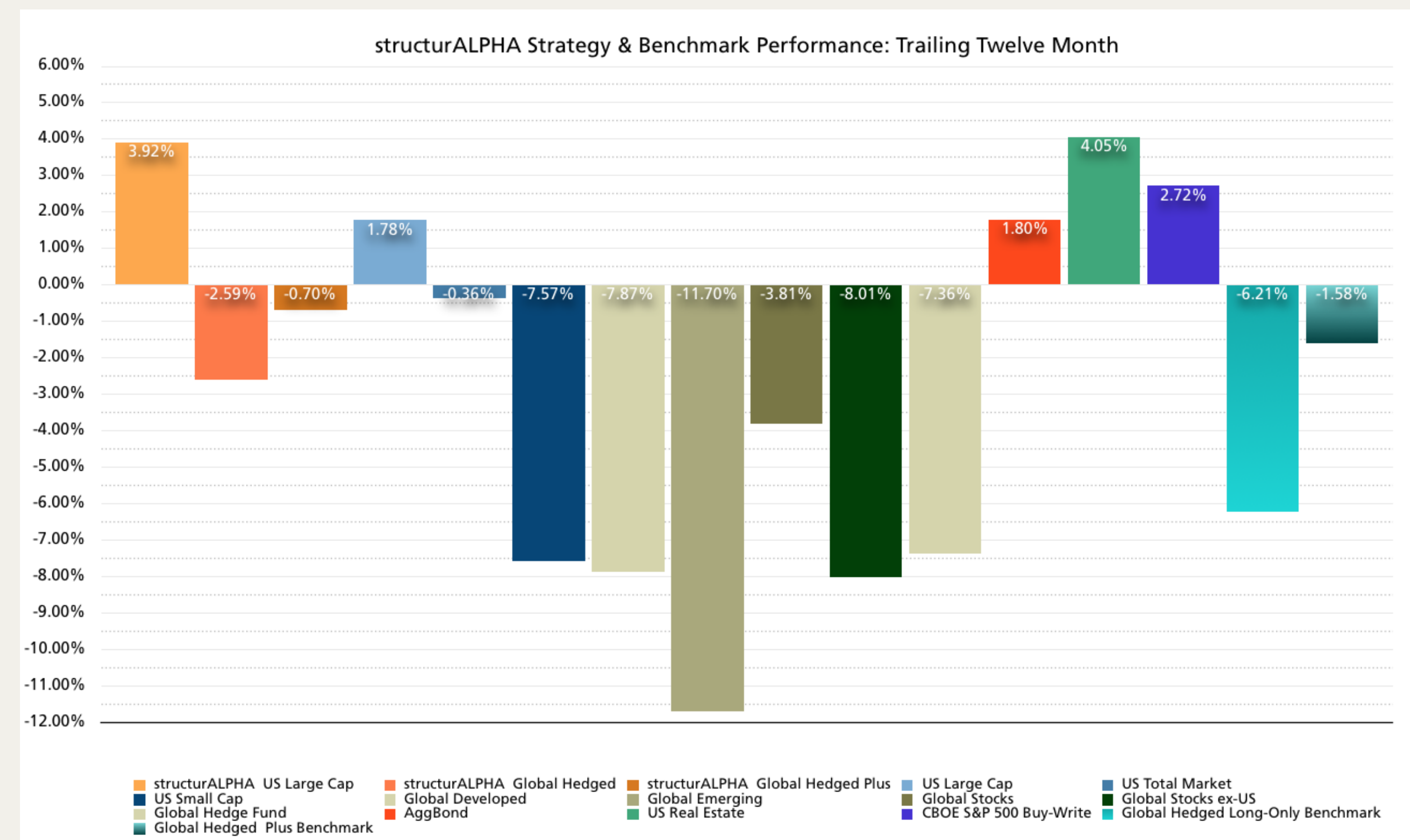
However, as we write about in an article in this newsletter, trying to maneuver in and out of the markets in the short-term not only does not work, it actually degrades returns. And as the powerful global rally again proves, "staying calm and remaining invested" is the surest way for investors to meet their objectives. Much of our job here at CSCM is to teach and train clients to sit tight and hold on.

"And the simple, unadorned and low-cost access to market exposures (of ETFs) is calling other investment propositions into question: namely active management and its especially pernicious variant—hedge funds."

The fundamental essence of prudent investing is to simply capture market returns at the lowest possible cost. This is why Vanguard and Blackrock/iShares now manage a combined 9 trillion dollars: they deliver global market exposures, at low-cost, with full transparency. Vanguard and iShares are two of the largest sponsors of Exchange Traded Funds (ETFs). With ETFs, investors can now access markets across the globe, with very low asset minimums, and can build globally diversified, optimally efficient portfolios. This is now a not-so-quiet revolution. Asset growth in ETFs is outpacing mutual fund asset growth 20 to 1. And the simple, unadorned and low-cost access to market exposures is calling other investment propositions into question: namely active management and its especially pernicious variant—hedge funds.

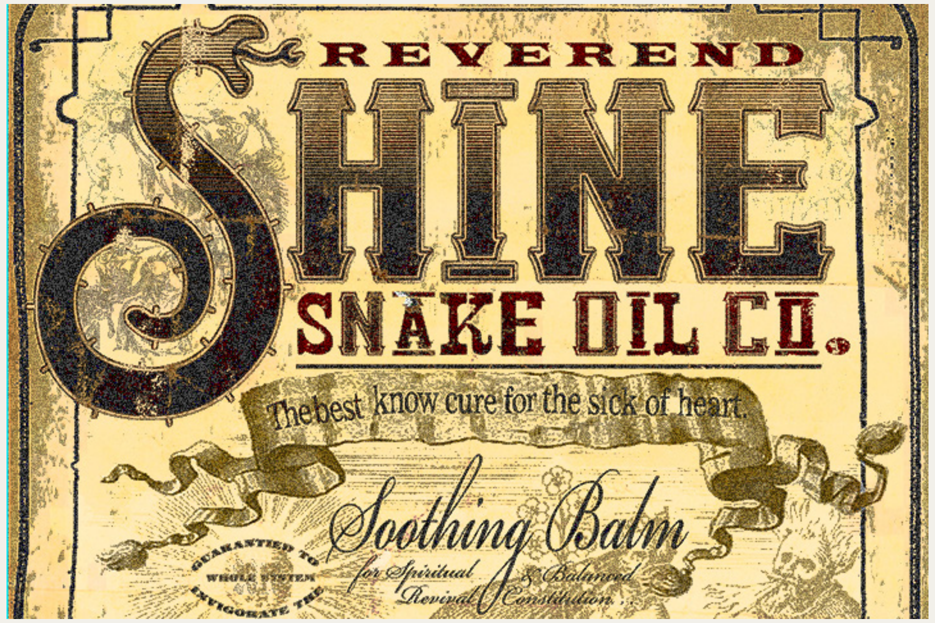
We believe that with the seven-year bull market growing old and an uneven economy persisting, market returns over the next decade will be below historical averages. To that end, we have biased our holdings towards income and yield, to collect more of a certain return, and to depend less on appreciation.

Our methodical approach to collecting option income is also a central aspect of earning incremental returns while mitigating risk. Continuing on the "market-capture as the essence of investing" theme, we use a rules-based approach to option-hedging to capture the natural time-decay of option prices. Building portfolios with structural, positive, market capture asymmetry is our self-selected mandate. Rules-based option hedging is a powerful tool to do just that.



Metaphorical Snake Oil

We see a lot of investment product pitches here at CSCM. The vast majority don't stand up to investment theory, practice or empirical scrutiny.



As a Registered Investment Advisor (RIA) we receive a great deal of inbound marketing, especially for investment products and strategies. The main proposition is almost always a performance advantage due to tactical pursuits—largely market timing.

Market timing strategies and their tactical brethren hold out the potential to move a portfolio to cash to avoid downmarkets and re-invest in the portfolio before the market again resumes its inexorable upward march. You might not be surprised to learn that most of these strategies come with a hefty fee burden. Hypothetically, avoiding much or all of market declines and participating in much or all of market advances would in fact deliver significant excess returns. They typically claim that they can read the market signals and tea leaves better than others and hence know when to take action. There is just one small problem: there is no evidence that it can be done reliably.

Here is a recent example, with the product sponsor and name changed to protect the guilty:

> ***From ABC Capital Management: "We offer a unique investment solution, that provides downside protection by moving our portfolio to 100% cash. Along with this protection feature we look to participate within strong markets."***

A recent communication (3-21-2016) from the firm says that having been in cash since December 17, 2015, they have recently received a Bullish signal.
A quick examination of the returns of a broad market index reveals that the ABC strategy missed all of the market sell-off through the lows of January 21st or February 11th. However, it appears that their strategy missed all of the rally back to current levels—a 12.5% rally.

"Hypothetically, avoiding much or all of market declines and participating in much or all of market advances would in fact deliver significant excess returns. There is just one small problem: there is no evidence that it can be done reliably."

The net effect of their actions appears to be a loss avoidance of approximately .5%, from December through 3-21-2016. In short, they did not participate in either the market sell-off or rally. After the frictions of transaction costs and capital gains, avoiding a .5% loss is less than pointless, it is destructive. There is no point in avoiding all of a 10% sell-off, if you miss the all of the 10% rally back. Where is the asymmetry and upside market capture they promise? See the chart below left.

It is easy to conclude that whatever signal they believe they can tease out of the market, it is not strong or reliable enough to provide the purported market capture asymmetry—less of the downside & more of the upside. And this small sample just confirms what reams of objective market analysis determines: that market timing is a fool's errand, the metaphorical equivalent of investment snake oil. But you can't charge a fat fee to earn market returns.

You Can't Charge a Fat Fee for Market Returns

We note that most of these tactical strategies come with a hefty fee. It stands to reason that a manager or product sponsor seeking a lavish management fee would necessarily need to craft a product/strategy construct and pitch around the potential to earn outsized returns. All across the investment management industry are managers seeking to maximize revenue by charging confiscatory fees, especially in the hedge fund world.

The hedge fund complex is a prime example of this dynamic. Industry-wide, hedge fund returns are very pedestrian, while their fee burdens are the largest in financial services. This low-return, high-fee proposition should not exist in a rational world. Yet the industry thrives. It can only be explained by the numerous behavioral blind-spots humans labor with.

The fantastic growth of the Exchange Traded Fund (ETF) market is a good sign that individual investors, institutions and advisors are increasingly acknowledging that paying high fees is a losing proposition, regardless of the management style of the investment. The ETF market has been built on low-cost, passive management. It has grown phenomenally for just that reason—they deliver market returns at very low cost. This is the investing paradox—that simply earning market return beats the vast majority of active strategies most of the time.

Naturally, such success attracts new entrants and since most of the trued and true benchmarks are already well covered in the ETF universe, variations on a theme are now proliferating: smart beta, liquid alternative, even active management inside the perfect passive management wrapper of ETFs. For example, just today we received a slick marketing package from one of the latest entrants to the ETF market fray—a large and well known insurance company and mutual fund complex. Time will tell how successful these new entrants will be.

The good news for all investors is that virtually any global market exposure can now be accessed at very low cost. The opportunity set for an asset mix is vast. This offers all investors more opportunity to diversify, enhance returns and manage risk. This is a good thing.

The *structur*ALPHA™ Strategies

*structur***ALPHA**™ **Single Market Hedged Strategies**	Hedge Cycle	*structur***ALPHA**™ **Global Multi-Asset Hedged Strategies**	Hedge Cycle
US Large Cap Buy-Write	monthly	Global Hedged	monthly
		Global Hedged PLUS	monthly

Why Clothier Springs Capital Management

Methodical, Reliable, Durable

Investors clearly need and desire risk-limited and modified strategies in the asset mix to optimize their portfolios and outcomes. Our mission at Clothier Springs Capital Management is to provide those risk-limited returnsets through *structur***ALPHA**™—Managed ETF strategies that incorporate a methodically implemented, structural hedge within a low-cost, liquid and transparent separate account wrapper.

For More: www.clothiersprings.com

Thomas F. McKeon, CFA is founder, principal and Chief Investment officer of Clothier Springs Capital Management, LLC. He began his career in the capital markets in 1980 as an equity and foreign currency options market maker on the floor of the Philadelphia Stock Exchange. In 1994 he co-founded West Chester Capital Advisors—a registered investment advisor—where he managed equity portfolios for both institutional and private clients. He founded Clothier Springs Capital Management in 2010 to manage portfolios that combine the cost and market capture advantages of passive investing with the superior return and risk profiles of rules-based hedged investing.