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Bear Market Survival Guide

Better Strategies. Better Protection.

Fox River CAPITAL

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Letter From the Fox River Capital Team

It was March of 2009. Over the last year the stock market lost over -55% of its value. America was in what was being called the Great Recession. The real estate market was in shambles. Home prices cut in half. Millions of homes underwater, millions of others simply deserted because the owners couldn't make the payments. The hemorrhaging wasn't limited to the U.S., however. All around the world, countries one by one joined into this global crisis.

Financial markets around the world crashed. Americans lost their jobs as unemployment rose. It was the worst economic calamity we had experienced since the Great Depression. The interesting thing is, not everyone experienced this recession equally. While most Americans were worrying about if their homes and retirement portfolios would have anything left in them when all was said and done, there was a small group of investors who were avoiding the effects of this downturn and, sometimes, even profiting from it.

We are not just talking about those hedge fund managers on Wall Street, those characters in the Big Short. Sure, some of those managers made a killing. But, we are talking about a small group of investors that were just like the average investor. The only difference is; these investors were prepared.

This small group of investors didn't have millions of dollars and they didn't have any secret information. It wasn't even about what they had. It is about what they did. And what they did was build their financial plan in a way that played defense against these bear markets. They may have done this through the help of a skilled wealth advisor or through some of the concepts in this guide. The point is, they took action.

This Bear Market Survival Guide is going to cover a number of different concepts and strategies that you can use to protect yourself from the next market downturn. We are going to show you ways to not only play defense but also turn that defense into offense. This guide isn't designed to go into exotic and complicated strategies that most people won't understand. Rather, it will be simple and easy to understand.

The real question mark in this whole process is you. Implementing these strategies can mean doing things different than the rest of the "crowd". You will ultimately have to make this decision, but it could mean leaving your current advisor. It could mean selling all of your stocks and mutual funds to avoid the next bear market. And it will definitely mean taking some action on your part. Our team is here as a resource for you. After reading this guide, if you still have questions or you are uncertain about your investment plan, email or call our team at the number below. We are here to walk you through the process and help in way that we can. We want to thank you for purchasing the Retirement Domination Bundle and can't wait to bear-proof your retirement.

Thank You,

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Introduction

Reframing the Idea of Investing

Why do we invest? Seriously, ask yourself this question. Why are you investing at all? Often times when I ask this question, the answer goes something like,

"Well, to grow my money of course!"

I typically respond with something along the lines of,

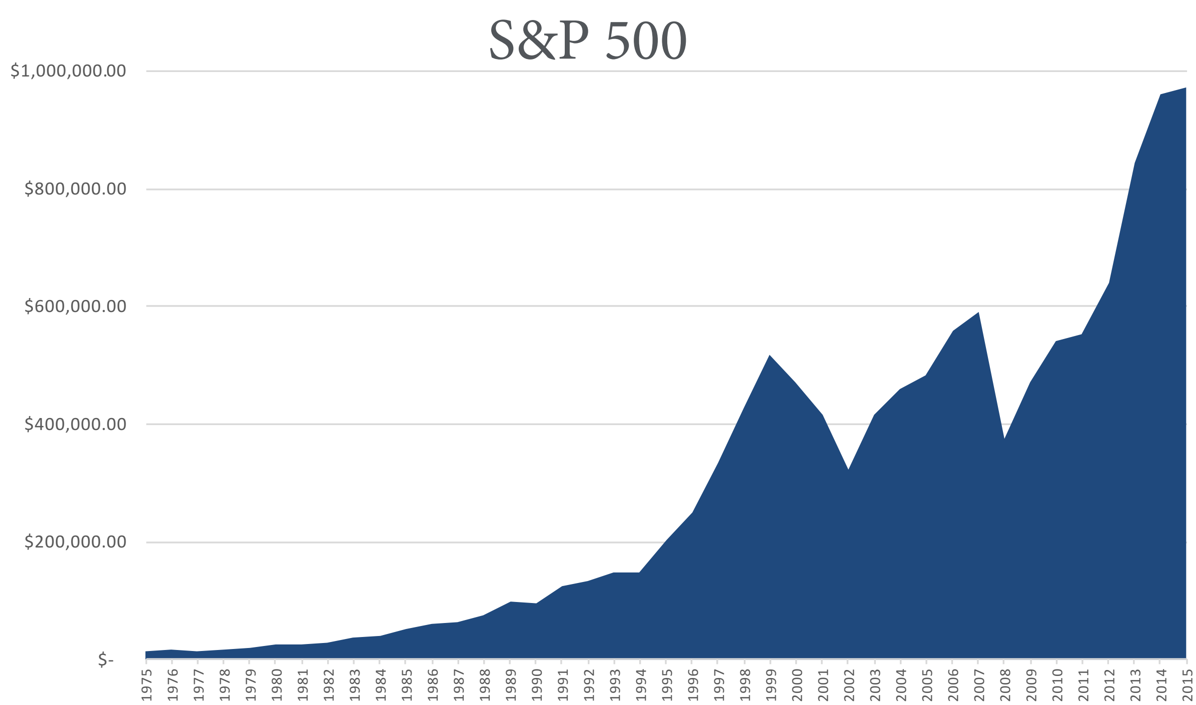
"Ok, so you just want to grow your money to be as large as possible when you retire, correct? So if you invested $10,000 today, do you care if it falls to $1 tomorrow?"

"Well of course I care, that would be a terrible investment!"

"What about it if fell to $1 tomorrow but the rose to $11,000 the next day. That would be a pretty good return for two days, don't you think?"

It's at this point the investor usually sees the point I am trying to make. Investing to grow our money is only half of the real goal for investors. The other half is, we want to grow our money in a safe and dependable way. This is the part that often gets left out for most investors.

If your traditional financial education was anything like mine, you were told that growing your money is a simple, easy, and repeatable process. All you need to do is invest in the American stock market or "good" mutual fund and eventually you will hit your goals. We get shown charts like the one below. If you would have invested $10,000 in 1975, it would be worth $972,572 in 2015! Wow, investing is easy!



By any measure, this chart is incredible. It is difficult to not blindly trust in the stock market based off a graph like this. Even though you would have experienced three significant bear markets during this time period, the growth would have outpaced any losses suffered by a market downturn. So is the key to surviving bear markets simply just to stay invested no matter the circumstances?

This is typically what traditional finance would recommend, however, there is a fallacy in this argument. First, the 40 years the graph spans happened to coincide with two of the largest bull markets the stock market has experienced. From 1988 to 2000, the stock market rose over 800% ! Using the largest growth period in the American stock market to make a case for investing is the equivalent of saying,

"Growing your money is easy if the best possible scenario happens!"

The second fallacy of this argument lies in the concept of timing. Theoretically, if growing our money through investing is so easy, it shouldn't matter if we started today or tomorrow, as long as we stay invested for a long period of time (40 years in this case). However, timing does play a huge role.

As we showed, $10,000 invested in 1975 would have turned into almost $1 million by 2015. But what if we started that $10,000 investment just five years earlier in 1970 and held it to 2010? It's still investing for 40 years, but the results are staggeringly different. This $10,000 would have turned into just $482,161, only half as much as starting in 1975.

All of a sudden, growing our money doesn't seem so easy. It appears the reason for this massive change is due to the addition of a bear market in data set. Adding another market downturn changes the outcome drastically! The timing of these bear markets becomes the most important variable for reaching our goals. It is for this reason that avoiding bear markets becomes paramount.

TIMING PLAYS A BIGGER ROLE THAN MOST THINK

The History of Bear Markets

13
Bear Markets Since 1900

-39%
Average Decline

67%
Time Spent in or recovering from a Bear

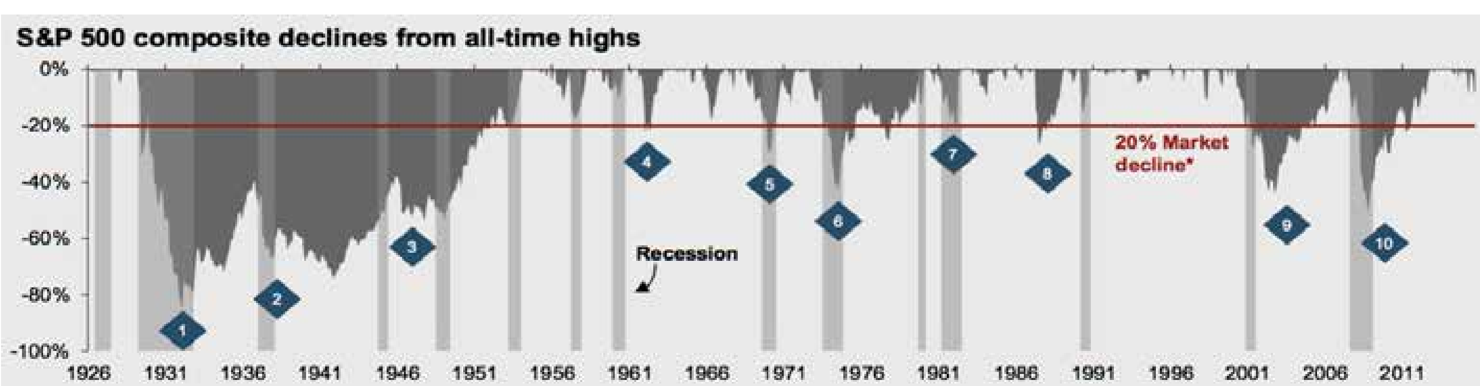
For clarification, a bear market is defined as a -20% or greater decline from the market high. Most people misinterpret these drawdowns as being rare. However, they are much more common that we think. From 1900, there have seen 13 of these events. The average decline of these 13 drawdowns was -39% . Below is a chart summarizing the last 10 market drawdowns.

Based upon the average time spent in a bear market, an investor in the stock market would have experienced a market downturn every 6.65 years on average. The average time spent in that bear market would be 2.2 years! This means that the full bear market cycle lasted 8.85 years.

Easily the most alarming thing about bear markets is the time spent recovering from them historically.

On average, it takes 3.7 years to recover from a bear market. That means if you were an investor in the American stock market from the beginning of 1900, you would have spent 67% of the time either in or recovering from a bear market! Over half of the time your investments would be making no progress. Over half of the time you are just trying to catch up from the last downturn! Growing our money doesn't seem so easy anymore.

The interesting point to note about each of these bear markets is no two are identical. There is no hard rule that states, "If you avoid x and y event, you can avoid 80% of bear markets." Part of the trouble of these downturns is they are difficult to avoid because they catch the majority of the population off guard. The population is caught off guard because they don't pay attention to history. Consider yourself properly armed.



How to Survive a Bear Market

Now that you know the frequency and severity of bear markets, we need to move on to the next logical step, and the title of this report. How do I survive these bear markets? We'll get to how we help our clients navigate these bear markets...let's first discuss how traditional finance approaches bear markets.

Traditional Diversification

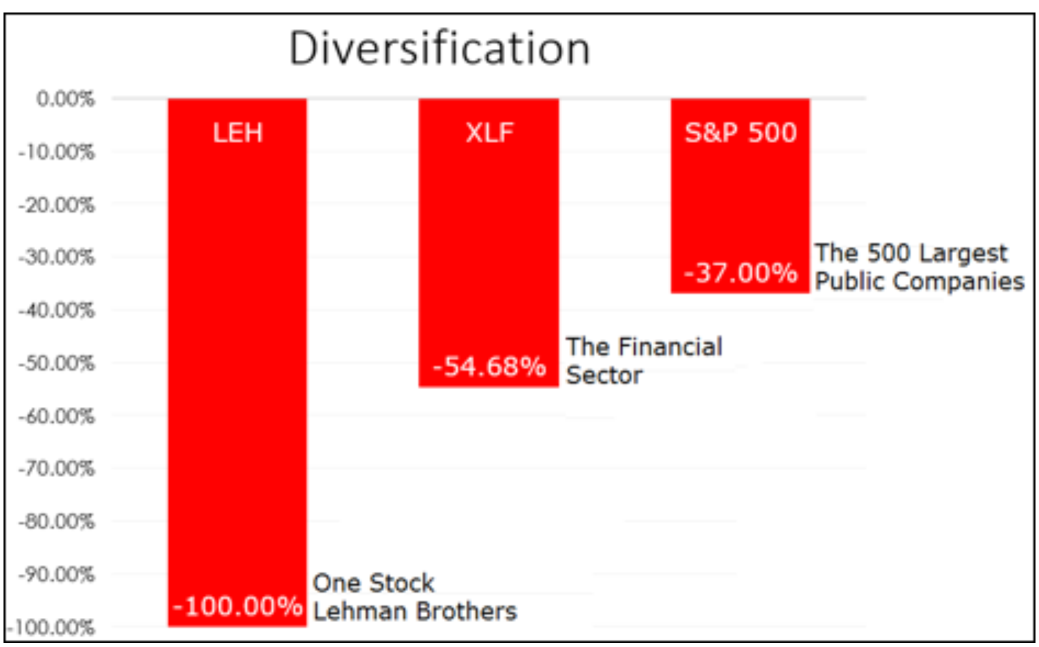
We've all heard the phrase "Don't put all your eggs in one basket." You probably already know how this applies to investing. Diversification, the simple principle of spreading out your risk.

Let's take stocks, for example. If you held stock in only Lehman Brothers in 2008, you saw your investment vaporize when they filed for bankruptcy on September 15th, 2008. Traditional finance would scoff at you for having all your eggs in that one (very risky) basket. Obviously only holding one individual stock would have been a massive failure, but even company-level diversification didn't improve the picture by a significant enough margin.

Look at the entire financial sector in 2008. Lehman went -100%, and spreading out amongst all the banks, brokerages, and insurers did, indeed, preserve some capital. Some, but not even half. You still would've lost almost -55%! Even if you took traditional diversification one step further and invested in the 500 largest publicly traded companies, you still would have lost -37% in 2008.

Note: This chart only shows the calendar year return. The max drawdown (defined as the drawdown from the peak value to the lowest value it fell to) was much greater for each of these investments. Lehman Brothers stayed at a -100% loss. The financial sector's max drawdown was actually -82% and the S&P 500's was -55%. This just shows how little of an effect company-level diversification can have.

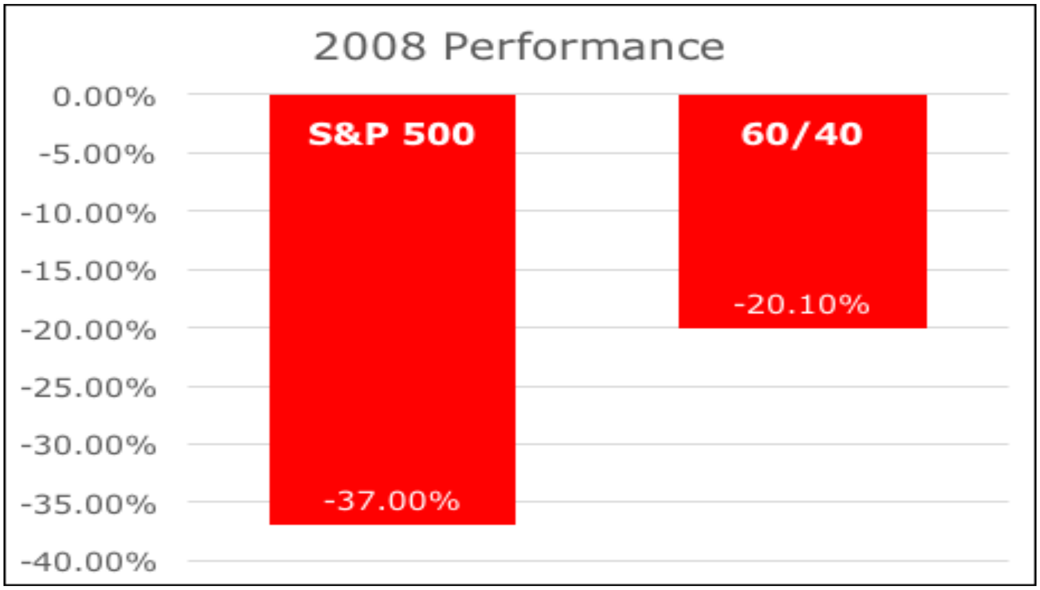
The traditional finance world diversifies, but they are mainly focused on company-level diversification. It would be disingenuous, however, to say that it's the only type of diversification they focus on. Let's



discuss bonds and the 60/40 portfolio.
Bonds are debt. A debt the company owes to whomever owns the bond. The bondholder receives interest payments for a set period of time, and on the final interest payment generally receives the face value of the bond (generally $1,000) back.

A common portfolio in traditional finance is the 60/40 portfolio. 60% Stocks, generally large cap U.S. Stocks, and 40% bonds, again, generally large cap U.S. bonds. An owner of a 60/40 portfolio owns stocks in over 500 different companies AND a completely different asset class, bonds from hundreds of different issuers as well. So how did this, more diversified portfolio fare in 2008? Significantly better...if -20% could be labeled "Better." Is that all there is? Are those your only options in a bear market? Lose -100%, -50%, -37%, or -20%? No. Not by a long shot.

Note: Once again, each of the max drawdowns would be significantly higher



FOX RIVER CAPITAL'S BEAR MARKET SURVIVAL PHILOSOPHY

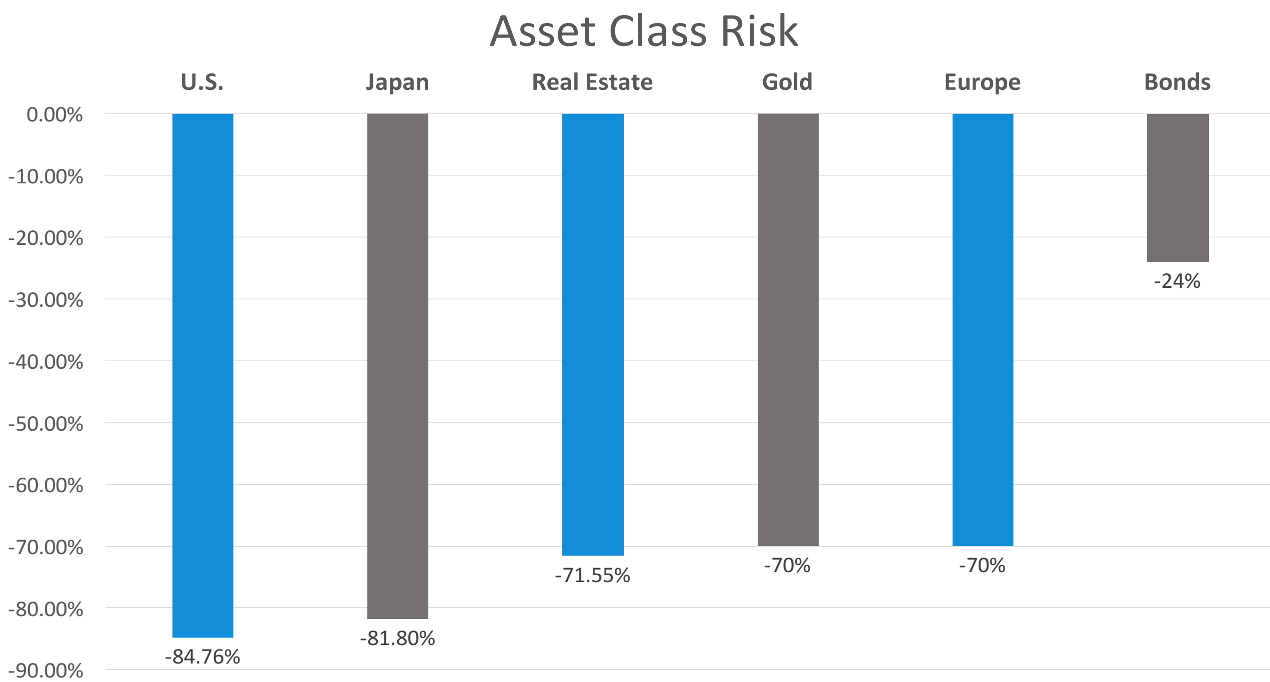
Strategic Diversification

The jury is out, diversification works but how effective it is will depend on how deep you can take diversification. A massive way to mitigate risk is by something our firm calls strategic diversification. Thinking about diversification in solely in the context of company-level diversifcation or a 60/40 allocation is a massive mistake. This is simply scratching the surface of diversification.

Strategic diversification goes much deeper. The thing about strategic diverification is no one strategy is enough. Lets take a look at asset-level diversification. Let's even go beyond the 60/40 simple allocation.

For instance, bonds are a different asset class than stocks, indeed, but they're only one different asset class. We could talk about all the other asset classes out there, from currencies to commodities, futures, options, swaps, emerging markets, real estate, precious metals, international diversification across stocks, bonds, and the list goes on and on…but there's a catch.

Regardless of asset class, losses can happen. (BIG losses.) Also, in bear markets, various asset classes tend to move together or become more correlated. (i.e. in 2008 Real Estate spilled into the banks which spilled into most other asset classes in the economy.) In these environments there's really only one place to hide, and it's an asset class you've probably forgotten all about.



Data gathered via in-house research on asset class's maximum peak to trough decline in different market environments. These declines are all-time declines. For example, the U.S. equity draw down happened in the depression, while the real estate decline happened much more recently.

Cash as an Asset Class

Since 1928, guess how many years you'd rather get a zero for your return than the return of the S&P 500? 23 times. Yes, 23 times a big fat goose-egg beat the S&P 500 since 1928. Roughly 25% of the time. This is not a fair representation of return, though. Cash doesn't (usually) return zero.

Guess how many times since 1928 you'd rather get the return of 3-month T-Bills than the S&P 500's return for the calendar year? 28 times. (And, yes, both of these examples included dividends for the S&P 500.) We're still only talking about being flat in a bear market…what about ways to grow your portfolio?

Directional Diversification

As a fundamental truth, we know that markets can go one of three ways; up, down or sideways. Most investment vehicles, like stocks, bonds, and mutual funds, do well in which of these conditions? "Bull" markets. These vehicles do well when markets rise. The problem is, markets only rise about 60% of the time. The other 40% of the time they either go nowhere or fall.

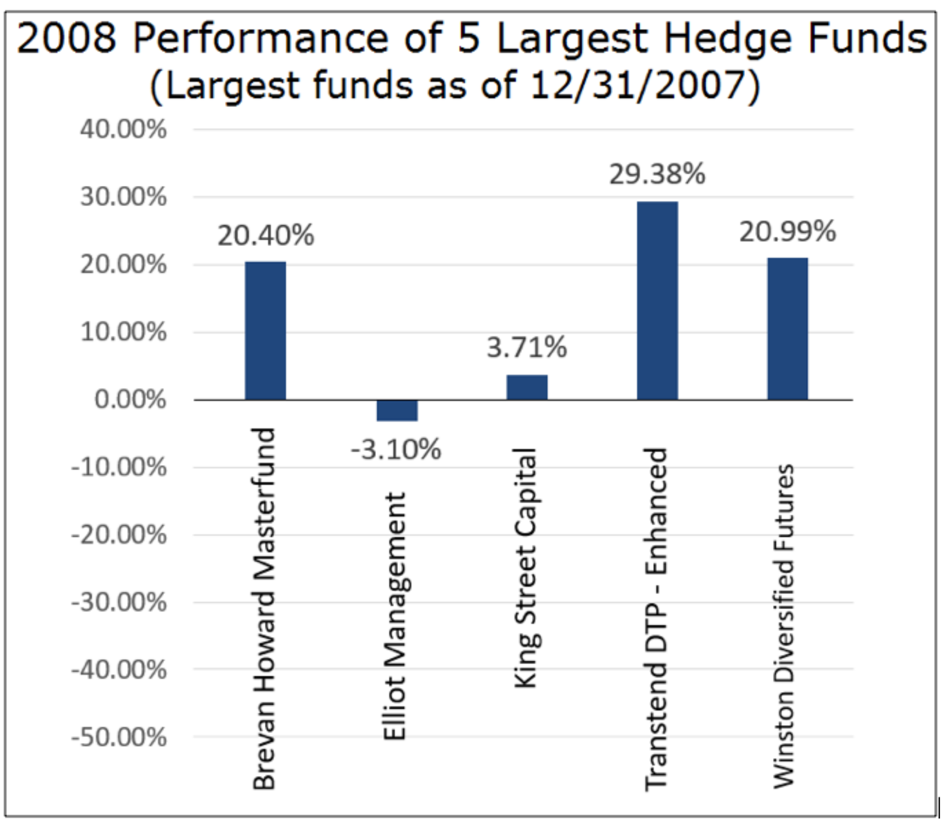
2008 was one of the most brutal bear markets in recent memory. As we showed above, the 2008 returns of the S&P 500 were -37.00%. We often hear the phrase "Everyone lost money in 2008." We hear it all the time, but is it true? (See chart below)

Now, does this information make you angry or curious? (Or both?) How did they do it? Well, as you might guess, most of them are highly diversified (as implied by some of their names) across many different types of assets. More importantly, they have the ability to "Go short."

Shorting is the process of profiting from the decline of an asset's price. The way shorting works is by borrowing and selling an asset you don't own today to buy it at a lower price in the future and return it, keeping the difference. (For example, borrowing a pen, selling it for $1, buying it back later for $0.50, returning it, and keeping the $0.50 profit.)

Many of the hedge funds shown below were able to profit in a bear market because they focused on being directionally diversified along with asset class and company diversified. Finally, many of the managers employ strategies that you may not even be familiar with.

And remember, these weren't the best performing hedge funds of 2008, just the five biggest.



The Wide World of Investing

How many investment strategies does your current investment portfolio hold? When we ask this question to investors, the vast majority of investors look at us as if our hair is on fire. What do you mean how many investment strategies? The reason so many investors are baffled by this question is because they are only implementing one strategy across their entire portfolio, buy and hold. They buy and hold stocks, bonds, mutual funds, indexes, you name it. However, this, once again, is limiting your investment options.

The world of investing is filled with hundreds of different investing strategies that are designed to do well at different times. For instance, a short list includes risk parity, pairs trading, mean reversion, covered calls, barbell, forex, statistical arbitrage, mergers and acquisitions, global macro, meta-strategy, fixed income, managed future, event driven, distressed securities, and the list goes on and on and on.

So how diversified do you think your investments really are if they are only using one type of strategy? Less than 1% of all strategies.

Let's give an example of one type of strategy. Some managers use a style called Long-Short. This means they are generally balanced (or have some kind of mix) between long and short positions. For example, they might buy Ford and short GM, or buy Microsoft and short Apple. The way it ends up is that these "Pairs Trades" offset market shocks. For example, if the tech market craters, and Microsoft and Apple both lose 10%, the 10% loss in the Microsoft "Long" position is offset by the 10% gain in the Apple short. Only divergences between the two companies themselves effect your bottom line.

The idea here being that one company is weaker (which would be shorted) while the other is stronger (which would be bought). If the broad market falls, theoretically the weaker one should fall more while the stronger one should fall less or possibly even gain. This spread creates a profit for this strategy. Again, this is just one type of strategy.

Part of the strategic diversification process is diversifying amongst different strategies. Some strategies perform well when the market goes down. Others perform well in the up market. If value can be created by diversifying amongst different companies, don't you think the same would reign true on a strategy level?

The Importance of a Systematic Approach

We all have one gigantic, glaring flaw when it comes to managing money. A flaw SO devastating, so lethal to our long term results it's absolutely breathtaking. We're human.

We have feelings, emotions, and biases. We overvalue the recent past and project it out into the future (recency bias). We continuously double down on bets, thinking "I have to win eventually," (gambler's fallacy). We seek out and are more likely to read and remember opinions that agree with what we already believe (confirmation bias). We overestimate our competence most in areas we are actually the LEAST qualified (Dunning-Kruger Effect). We treat money we win in a raffle very different than money we had to work for (found money fallacy). Losses affect us more than wins. Pain hurts us more than the joy we get from pleasure. We jump on the bandwagon in euphoric market tops, and panic and quit in bear market bottoms. So how can we overcome this inherent human weakness? Systems.

Rules for what you'll buy and in what conditions you'll buy it. Rules for what you'll sell and in what conditions you'll sell it. Rules for how many assets you'll hold, how you'll choose investments when both are attractively priced. Rules.

On the surface this seems very restrictive. How can investors possibly survive bear markets if they are confined to a set of rules?

As Jocko Willink, decorated Navy Seal said, "There is freedom in discipline." Although Jocko wasn't talking about investing, the same philosophy applies. Implementing rules and investing off of a system actually improves our investing.

It allows us to test rules historically. We can take human emoition completely out of the equation. This frees up time, energy, and in our opinion, is the most logical way to invest.

Investing with a rule set doesn't have to be complicated either...

"The System is the Solution -AT&T

A Simple Systematic Example, QTAA

Let's take one simple systematic example, Meb Faber's Quantitative approach to Tactical Asset Allocation. Meb published an article in the Journal of Wealth Management in 2007 explaining a new strategy. This extremely simple, rules-based investment strategy is meant show how impactful a rules-based system can be.

A simple version of QTAA is to take the 10 month moving average (an average of the closing prices on the last day of the month for the past ten months) of the S&P 500. All of this can be calculated by downloading historical data market data from a database like Yahoo! Finance.

After you have calculated the 10-month moving average, at the end of each month, compare the stock price to the most current 10-month moving average. The rules are as follows:

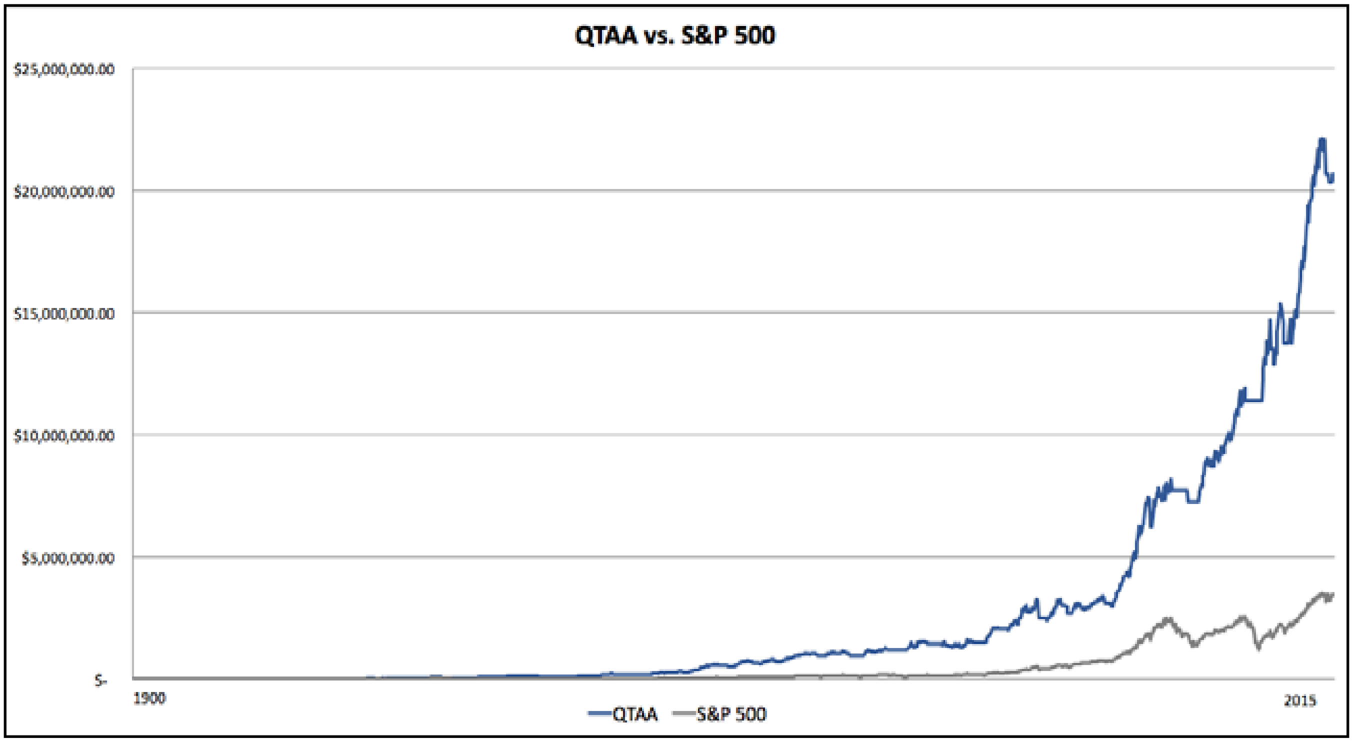
BUY RULE:

Buy when monthly price > 10-month moving average

SELL RULE:

Sell and move to cash when monthly price < 10-month moving average

And that is it. The system is as simple as that. Now let us make a quick disclaimer, we are not saying that this is how you or anyone else should invest. We just show this chart for illustrative purposes to show the impact a set of rules and a system can have. And the results are quite impressive...



Looking back at this historical results, this system did two things incredibly well. First the rule set forced the investor to use cash as an asset class and use it strategically. Looking back, 65% of the time from 1900-2015, this strategy would have kept investors in the market. Simply invested in the S&P 500. The 35% of time it was in cash, it was attempting to avoid market downturns. And that brings us to the second point, this strategy would have lessened the impact of almost every bear market. It wasn't perfect, it wasn't the holy grail, and It wouldn't have outperformed every year, but it helped manage the risk side of the equation.

It bears to note, however, that when one investment performs that much better over a long period of time, it becomes difficult to truly grasp how they did on a relative year basis. For instance, if I asked you which fund performed better in 2015, it looks like QTAA did just because it is a bigger line. To remain as open and accurate about this strategy, we thought it would be best to show you the same graph on a logarithmic scale. This puts the y-axis on an exponential increase and allows for investors to compare more accurately.

On the graph on the next page we can more accurately compare the large market downturns. Remember, this is the same graph with just an adjusted y-axis.

Looking at this strategy from a diversification sense, we see that it checks off the proper boxes. This strategy diversifies on the company-level by holding the S&P 500. It checks off on the asset-class level holding both cash and American stocks (albeit a limited diversification). It checks out on the strategy-level. A strategy such as this is called a momentum strategy. And it even checks off on a directional diversification level. During up and sideways markets it is designed to stay long and during down markets, it is designed to go into cash. Even though it checks the box off, this is still a weaker directional diversification.

QTAA was designed to be a simple rule set to show the power of systematic investing. It checks out all of the boxes for strategic diversification, but doesn't

quite fulfill them all as well as our firm likes to see. QTAA is meant to manage everything on a risk adjusted return basis. This means high return isn't beneficial if it brings with it high risk. If your portfolio performs +30% one year and -30% the next, you will be doing worst than a portfolio that gained +20 the first year and -10% the second.

Disclaimer: Any information provided is not to be intended as personal investment advice. All investments entail risk and each should be carefully considered. QTAA was used for illustrative purposes only and is not specific investment advice. Fox River Capital makes no representations to the accuracies, completeness, suitability, or validity, of any information shown. Investing comes with risks and past performance is not indicative of future results. Consult a licensed financial professional.

Overly Rigid: Mutual Fund Prospectus & Investment Mandate

Most of us have heard of mutual funds. In fact, the typical investor probably invests in a mutual fund. A mutual fund is a fund where your money is combined with other people's money, managed by a professional, and then redistributed back to you when you need it. Putting it in this context, mutual funds sound extremely attractive. Unfortunately, sounding and performing are two different things.

Every mutual fund is bound by a registration document, a set of rules called a prospectus. If this sounds like a systematic strategy, it's not. Or at the very least, it is a very weak one. A prospectus covers all the topics that are pertinent to investing, from important tax information, all the way to what the fees and expenses are. Within the prospectus, the fund manager must also define the investment objectives and strategies. By defining these, the fund manager is then bound by them.

Unlike a systematic approach like QTAA which can change its allocation depending on conditions, the process of defining the investing strategy in a prospectus actually decreases flexibility. For instance, prospectuses have to define a minimum percent of assets that must be invested at all times. Many funds set this at a minimum of 60% or higher. This means that if you own a large cap mutual fund, it must always be at least 60% invested in large cap stocks. So yes, even in years like the recession of 2008 when the market dropped over 50% at one point, that mutual fund would very likely feel at least 60% of that loss.

Prospectuses appear to hamper fund managers so much that they don't eat their own cooking. A study released by Morningstar called "Do Managers Eat Their Own Cooking?" found that only 47% of fund managers actually invest in the funds that they run. 53% of mutual fund managers don't invest in the funds they manage! The managers lack confidence. If the people running the fund don't have confidence, why would you?

Maximum Drawdown & Your Panic Point

Do you know the historical maximum drawdown of your portfolio? Do you know, for example, how it would've done in 2008? Have you ever stress tested it? Do you know how it would've handled September 11th, 2001?

More importantly, do you know yourself? Do you know how you feel down -10%? Down -20%? Down 40%? Do you know where you are likely to "Panic" and want to move to cash? Do you know how your portfolio's maximum drawdown compares to your panic point? If your maximum drawdown is -40% and you panic at -20% and a bear market happens on average every 6.6 years, how realistic is it that as a valid long term investing plan for you?

It's not realistic and in fact, investing blindly hoping that you never experience a -20% drop or more is the equivalent of hoping your broken down car fixes itself. If you have doubts or frustrations about your current investments, then take action. If you are savvy enough, you may be able to implement something like QTAA. If not, look for help. And we want to start off that search for help by offering out services to you. At no-cost, a free consultation is offered to you with this Retirement Domination Bundle. We will individually design a full comprehensive retirement and investment plan to make sure your expectations are being met. We want to thank you for taking the first step by purchasing this bundle. The only thing left is action.

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