Tactical Investing Yields SUCCESS

Protecting client assets with successful tactical wealth managers is the key to long-term investment management.

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In volatile times, knowing when to take a risk and when to walk away is the key to success. Drew K. Horter, president, founder and chief investment strategist at Horter Investment Management LLC, helps clients balance risk and investment success. The firm oversees more than $1 billion in assets under management, and has more than 200 investment advisors and relationships with more than 50 independent advisory firms, representing over 100 additional investment advisor representatives. These advisors are located in 44 states including Hawaii.

Horter talked to LEAD Management about facing challenging market conditions:

LEAD MAGAZINE: Can you share what the investment philosophy of Horter Investment Management is?

HORTER INVESTMENT MANAGEMENT: At Horter Investment Management we believe in tactical investment management. Unfortunately, the term "tactical" has been used loosely within our industry, but to us it means having the ability to move to a "risk off" or cash position to sidestep significant downward moves in the markets. With lower downside risk, lower volatility and the ability to make gains within the portfolio regardless of the market's direction, we believe our clients will be able to achieve investment success. More specifically, we seek to achieve superior risk-adjusted returns over a full market cycle compared to a traditional 60 percent equities/ 40 percent bonds asset allocation.

LM: With interest rates expected to gradually increase, how is your firm preparing for this anticipated event? What adjustments, if any, are you making in your money management strategy because of it?

DH: Fortunately, we have multiple money managers on our platform that have successfully navigated rising interest rate environments. There seems to be little debate on whether interest rates will rise, the uncertainty is at what pace rates will rise. Each of the private money managers we work with are what we would consider "specialists". We've integrated each one of them in such a way that we're diversified across asset classes and management style, so that our clients are invested in assets that are not sensitive to interest rate moves, or are less correlated, and their portfolio is equipped to handle any sort of pace that rates increase.

Our strategy remains low risk, low volatility at its core. Should interest rates increase quickly, we've integrated models into portfolios that can benefit from these moves. In a situation where interest rates rise at a very slow and drawn-out pace, we've integrated models that will move into the strongest income producing areas with the least sensitivity to rate changes. This particular scenario continues to be a struggle for fixed income investing, as interest rates continue to be historically low for a very extended time.

LM: Can you describe the flexibility and benefits provided by Horter's Tactical Asset Management platform for your clients?

DH: Our clients tend to be conservative in nature and without a doubt, one of the main benefits they enjoy is knowing that every minute of every day someone is

watching their hard-earning savings looking to make a move into cash, into a defensive position or into an opportunistic position. They are not subject to the large draw-downs that are a part of the "buy and hold" process. It's a peace of mind that is hard to place a value on.

The flexibility each of our managers have in being able to protect principal and take positions to make money in any given market environment is special. We've positioned each of our models in such a way that they truly complement one another. We like to say that we are opportunistic in good times and defensive in bad. At the end of the day, it provides our clients the opportunity to not only protect their investment principal in any market environment, but participate with gains in any market environment – up market, down market or a sideways market. Our clients do not have to rely on markets to make new highs to realize growth in their portfolios. It is reassuring for them to know that they do not sacrifice upside opportunities in exchange for managing downside risk.

AT A GLANCE Horter Investment Management Facts

- 2014 Ranked # 1 Nationally by Financial Advisor Magazine by Percentage of Growth in Assets in the $500 million to less than $1 billion category.
- 2015 Ranked # 6 Nationally by Financial Advisor Magazine by Percentage of Growth in Assets in the $1 billion to less than $2 billion category.
- 2015 Recognized as a Top Money Manager by the Cincinnati Business Courier
- 2013 Fastest Growing RIA with Custodian, Trust Company of America

LM: How does your firm determine what are the most important factors to consider when recommending investment products to clients?

DH: For us it is very simple: As a client, what is the maximum loss you would accept before you would begin to feel very uncomfortable? At its core, isn't that the question every risk tolerance questionnaire or test is trying to answer? Let's skip the dance and just address it upfront. We use the term "maximum draw-down" a lot. It's nothing more than a measure of change from a portfolio's top value to its bottom value. If a client's account was at $300,000 and dropped to $240,000, would that client become very uncomfortable? Would they be tempted to change their investment approach, or even get out of the market? Unfortunately, emotions are an investor's worst enemy. Even though it's only a 20 percent draw-down in this example, it's $60,000 of a client's hard-earned life savings that they cannot afford to lose. Compare this to the 35 percent maximum draw-down of a 60/40 allocation (balanced by most industry standards), and clients are constantly battling their instincts over their investment positioning recommended by their advisor.

We go through a simple process with our clients of "bucketing" their overall assets based on maximum draw-down. Through a small series of questions we will have an allocation comprised of principal guaranteed investments (where clients cannot lose money), low risk investments with lower draw-downs, and moderate risk investments with slightly higher draw-downs but nowhere near the S&P 500 maximum draw-downs. This Managing Risk 3 Buckets approach clearly defines the expectations and experiences along the way for both the advisor and client. We strive to recommend portfolio allocations that will not continuously test a client's risk tolerance while delivering above average returns in helping them meet their financial goals.

LM: It's been five years since Dodd Frank became law and placed major regulations on the financial industry to protect consumers as a result of the financial collapse in 2008. Can you give us a fresh look on the impact it's had on the industry and consumers?

DH: The consumer has been better protected and informed through this legislation, and we always believe that is a good thing. It has definitely had an impact and changed the industry. Consumers have never had as much transparency and information about the financial industry as they do today. As a fiduciary it is our responsibility to do what is in the clients' best interest as well. The flipside of that is can the consumer process all of this to make better decisions? We live in a 24/7 on-demand world, so how does the consumer decipher what is fact and what is misconception? Will it protect everyone from another financial collapse? Only time will tell. Even with the best of intentions, sometimes people cannot even be protected from themselves.

LM: Since the Fed isn't expected to raise rates aggressively, does this mean income-oriented investors are going to be at a disadvantage for some time yet? If so, what's your firm's advice to your clients on how to produce above average returns without a large degree of risk?

DH: In reality, it is really secondary on when the Fed actually decides to raise interest rates. The real factor to consider is how the market behaves in anticipation of a Fed

decision. If investors look to exit a popular trade (which fixed income has been) and there is a run on redemptions, you don't want to be the last one out of a burning building.

Fixed income investors have been at a disadvantage for quite some time. With interest rates being held at these historically low levels for an extremely extended period of time, traditional fixed income investors have been forced to look elsewhere for return. It starts with a bit more risky fixed income investment, then gravitates into dividend-paying stocks and then possibly into real estate or master limited partnerships. This is all done in an effort to maintain an income or cash flow from their investments. All the while, the client has significantly increased their exposure to risk and maximum draw-down.

We are recommending clients continue to reallocate to investments that don't have as much interest rate sensitivity. In addition, we are allocating more of the portfolios to models that can hedge interest rates. This allows clients to stay invested in traditional fixed income or income oriented investments without being significantly impacted by rising interest rates.

LM: In an economic environment where rates gradually increase, how do you expect the stock markets to react short and longer term?

DH: There are several reasons that make this particular rising rate environment very challenging. In preparing ourselves for the future, we need to take a look back to see how we've arrived at where we are. The Federal Reserve reduced the Federal Funds Rate from over 5% to 0%-0.25%. The economy did not respond and more was needed. The Fed then embarked on Large Asset Purchasing programs, purchasing mortgage and treasury bonds (the most sensitive of fixed income investments) in the open market. Through this process, the Fed essentially has created the "effect" of interest rates below zero.

In addition, bank debt capital issuance has touched an all-time high as new rules in the aftermath of the global financial crisis have prompted global financial institutions to shore up their balance sheets with unprecedented volumes of subordinated bonds. Global banks more than doubled debt issuance last year – driven by a sixfold rise in Asian bonds. Just about every region in the globe has entered some form of "easing". This means that as interest rates begin to rise, which will more than likely start here in the U.S., the effects will ripple around the world.

Keep in mind that the Federal Reserve only controls the Federal Funds Rate, which is nothing more than the overnight rate banks lend to one another and the Discount Window. They do not control the rates on bonds. The most conservative investors have been forced to expand their natural risk tolerance and move into riskier investments in their search for yield. Their first stop – bonds. In an extremely overcrowded trade, the most fearful investors will be quick to exit. Whether it's in anticipation of, or a reaction to a rise in rates, we believe all markets will move quickly. We see an environment full of volatility in short spurts. If you can envision a crowded room with everyone huddled near the door, just waiting for the fire alarm to be pulled or someone to smell smoke before starting to race out . . . that's how this market feels. Sometimes there isn't even an alarm that rings or the smell of smoke, sometimes it's just the rumor of smoke that sends people crashing through the door.

LM: What is your firms view on how best to prepare and monitor the markets to continue providing above average returns while maintaining a reasonable amount of safety and stability in their portfolios?

DH: We believe that markets always change, but investor behavior doesn't. That being said, we look much closer at different areas of the markets that tend to be leading indicators and a direct reflection of investor behavior. Whether it is high yield bonds or small cap stocks, or even a flight to quality in the perceived "safest" of assets, all of these are taken into consideration when constructing our client portfolios.

We've seen some deterioration and breakdowns in several areas of the markets that have led us to position our portfolios more defensively. The recent volatility in long-term treasuries has been extremely high. This is due to the anticipation of the Federal Reserve potentially raising the Fed Funds Rate and the growing concern of slowing global growth and ultimately a flight to safety.

Both high yield bonds and small cap stocks began to breakdown in June. The majority of the fixed income world has been down for most of this year due to the fear of rising interest rates. Taking everything into consideration, we have been in positions that are not sensitive, or have very little sensitivity, to interest rates. In addition, we have been in larger-than-normal cash or "hedged" positions for the last few weeks. This has allowed us to better protect our clients from what we foresee as a very volatile and challenging period for equities.

Safety and stability are some of the main reasons our clients have chosen to work with Horter Investment Management. In addition, our ability to sidestep potential market drawdowns and exploit opportunities, allows us to deliver above average returns. We believe that we're entering the beginning of an extremely challenging environment, and our clients have very little anxiety.

Horter Investment Management is located at 8316 Cornell Road, Cincinnati, OH 45249. You can reach them at 513.984.9933 or visit their website at www.horterinvestment.com