A UNIQUE LENS ON RISK MANAGEMENT

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On last week's episode of our "Behind the Markets" podcast, Liqian Ren and I hosted an investment strategy discussion that covered factor investing, U.S. sector trades and the global outlook with Matt McAleer, Director of Equity Strategies at Cumberland Advisors.

Later, we were joined by Allison Schrager, economist and author of the new book, "An Economist Walks into a Brothel: And Other Unexpected Places to Understand Risk." Schrager talked about managing risk when preparing for retirement, trading bonds and more.

An ETF Strategist Discusses His Global Outlook

In Cumberland's portfolios, capital is primarily allocated through ETFs. Fifty percent of their portfolios are typically invested in a broad manner and through indexes, such as small-, mid- and large-cap or equal-weight strategies. McAleer prefers equal weight over weighting by market capitalization, saying it provides more breadth outside of just the top portion of companies.

Currently, Cumberland has raised some cash in their equity portfolios, taking on a more defensive stance. However, when asked if that more defensive posture would support a factor such as low volatility investing, McAleer finds "low vol" or minimum variance indexes to be overcrowded in the short run and thus too expensive relative to the growth they offer.

Outside of broad index allocations, Cumberland also utilizes a sector rotation strategy. McAleer discussed adding to Health Care after recent weakness and underperformance.

Abroad, McAleer watches the relative strength of international markets compared to the U.S. and noted that Europe's equity markets have started to look better. He wonders if this is a false sign, or if the markets are truly catching up to the excess liquidity provided by the European Central Bank.

In emerging markets (EM), McAleer noted how rising U.S. interest rates have caused EM to underperform at times and that the freeze in Federal Funds Rate hikes has been a large reason why he has gone over-weight in EM. For the first time in a while, Cumberland has raised exposure for EM to almost equal the weight of developed international markets in their portfolios.

Unique Stories of Risk Management

There are many books that discuss risk and the pricing of risk through complex, quantitative prisms.

Schrager explains risk through a unique storytelling lens, best exemplified by her new book, "An Economist Walks into a

Brothel: And Other Unexpected Places to Understand Risk."

Schrager did her PhD in the economics of retirement, where the essential question is, "How do you make your assets last longer throughout your life?" She finds most people have trouble understanding risk and applying it to their lives, even when assisted by a financial planner.

Schrager says most view retirement as accumulating income, managing losses and maximizing the pile of money for retirement. However, the real goal is to smooth resources throughout your lifetime and have predictable income in retirement. This is achieved by managing a variety of factors, such as interest rate risk, and understanding how much income you want and need.

For advisors focused on retirement planning who need to explain risk to clients, Schrager's book is a captivating and quick read that will help communicate interesting stories.

For a quick teaser on the book, listen to our full conversation below.

For standardized performance and the most recent month-end performance click here NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our Economic & Market Outlook

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DEFINITIONS

Factor : Attributes that based on its fundamentals or share price behavior, are associated with higher return.

Small caps : new or relatively young companies that typically have a market capitalization between $200 million to $2 billion.

Mid-Cap : Characterized by exposure to the next 20% of market capitalization (after the top 70% have been removed) within the Value, Blend or Growth style zones with the majority of the fund's weight.

Large-Capitalization (Large-Cap) : A term used by the investment community to refer to companies with a market capitalization value of more than $10 billion. Large cap is an abbreviation of the term "large market capitalization". Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.

Market Capitalization : Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

Defensive characteristics : Greater exposure to the so-called more defensive sectors, especially Telecommunication Services and Utilities.

Low Volatility : Characterized by lower standard deviation of price over time. This term is also associated with the Low Volatility Factor, which associates lower volatility stocks with better risk-adjusted returns vs the market over time.

Variance : a measure of the spread between values in a data set.

Liquidity : The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid asset.

Federal Funds Rate : The rate that banks that are members of the Federal Reserve system charge on overnight loans to one another. The Federal Open Market Committee sets this rate. Also referred to as the "policy rate" of the U.S. Federal Reserve.

Interest rate risk : The risk that an investment's value will decline due to an increase in interest rates.