PARITAS
CAPITAL MANAGEMENT

Understanding Balanced Risk Portfolios

Authors

Douglas Hedley
Chief Investment Strategist

Michael Pakula
Portfolio Manager

Time to Embrace a New Approach?

Most investors are familiar with the notion of allocating capital to stocks and bonds to create a traditional "balanced" portfolio.

Conventional wisdom dictated that capital allocated 60% to stocks (both US and non-U.S. equities) and 40% to bonds would typically satisfy the desired long-term growth and/or income needs of most individual investors with modest risk-tolerance levels.

Today however, advances in portfolio construction research have led to fresh, open-minded thinking on how to build better portfolios that can benefit from managing risk. Since so many traditional 60/40 balanced portfolios have underperformed their benchmarks, the goal is to find a solution that can deliver more-successful financial outcomes with greater consistency.

Risk Management: The Key to Long-Term Success

Managing risk can be a very delicate topic when it comes time to discuss how to best invest a person's hard-earned wealth.

Investopedia defines risk management in a portfolio context as follows:

> *Risk management is the process of identification, analysis and acceptance or mitigation of uncertainty in investment decisions. Essentially, risk management occurs any time an investor or fund manager analyzes and attempts to quantify the potential for losses in an investment and then takes the appropriate action (or inaction) given their investment objectives and risk tolerance.*

At Paritas, we manage wealth to be able to withstand unexpected, and oftentimes sharp, market declines and to protect against absolute loss. Our proprietary research goal is to minimize the chance of capital loss and reduce the probability of experiencing any unsuccessful outcome.

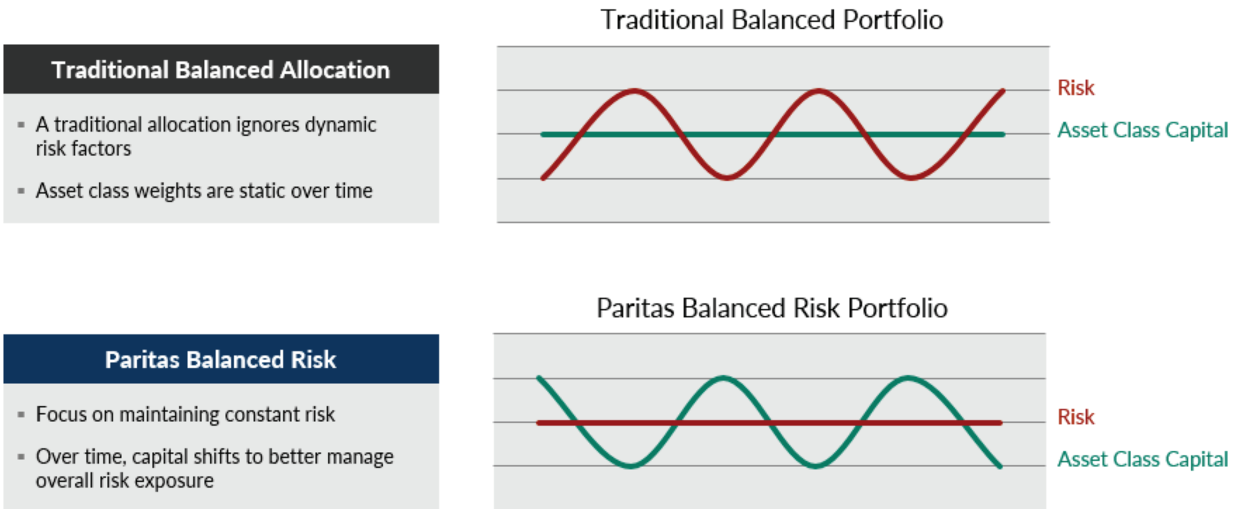
Therefore, our analysis focuses on quantifying and monitoring risk, especially since it is constantly changing. We want to build well-diversified portfolios that can adapt quickly to those changes.

Balanced Risk Portfolios: A "Common Sense" Approach

Paritas constructs wealth-building strategies using a balanced-risk methodology, which we believe is the optimal way to protect a portfolio from unnecessary downside market volatility while still offering potential for capital appreciation over time.

A balanced risk portfolio is very different from the traditional 60/40 type of portfolio. A balanced risk portfolio starts by quantifying ***risk*** rather than simply allocating capital to stocks and bonds using arbitrary, formulaic weights like 60/40. The conventional thinking for a traditional portfolio was to set a fixed target level for an allocation of capital that could help control the higher risk attributes of equities relative to less volatile bonds.

The conceptual framework of the traditional 60/40 portfolio is the inverse of a balanced risk portfolio:



For traditional long-term investors, the risk level is permitted to fluctuate over time as stock and bonds trade leadership. Sometimes, the risk level was high, at other times the risk was low.

Balanced-risk portfolios address these capital market anomalies better by carefully quantifying the risk and then allocating the capital.

The balanced risk strategy works well when market volatility inevitably strikes; the investor experiences less monetary loss due to the protective design of the balanced risk strategy. To accomplish this goal, the balanced risk portfolio must be rebalanced systematically to re-weight the risk budget evenly.

Global Wealth Strategy: A Sophisticated Balanced Risk Portfolio

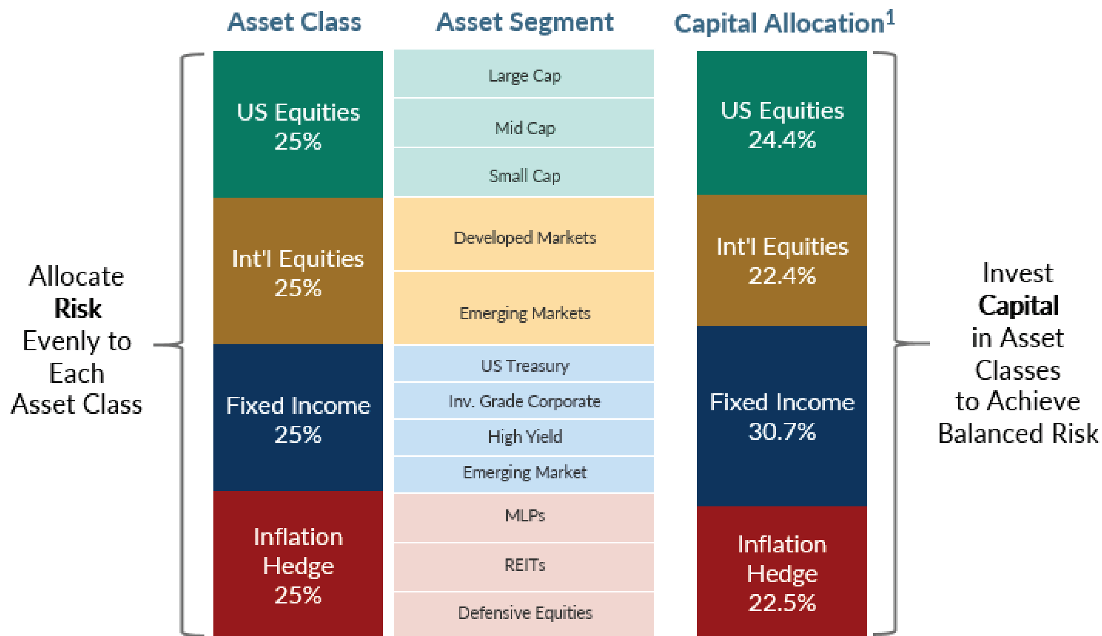
The primary goal of Paritas' Global Wealth Strategy is to balance different types of risk that can cause capital loss. Our approach is premised on the thesis that minimizing a portfolio's downside risk is the key to generating outperformance over bull and bear market cycles. We carefully analyze and research risk to build a portfolio that can better ensure you will get paid fairly for the risk level you are willing to assume.

Using a rules-based quantitative methodology leads to a systematic and repeatable investment process. The GWS portfolio is comprised of four asset classes: US stocks, International stocks, Fixed Income, and Inflation Hedges. Each class has a risk allocation of exactly 25%. Using our proprietary research, we then allocate capital. Over time, as the risk changes, we rebalance the capital allocations.

The display on the following page highlights how we quantify and balance risk first, then we allocate capital.

BALANCE THE RISK, THEN INVEST CAPITAL

Construct a globally diversified portfolio invested across asset classes and segments



[1]As of 3/31/2017. Asset allocation/diversification does not guarantee a profit or eliminate the risk of loss. Past performance is not a guarantee of future results.

The riskier an asset becomes, the less we want to own. Each asset class has the same potential effect (both positively and negatively) on the portfolio.

We invest globally in the largest and most liquid markets and we focus on owning the "purest" asset segment ETFs instead of attempting to identify individual securities with high return potential. This helps to mitigate risk and reduces the potential downside impact of a significant market meltdown event.

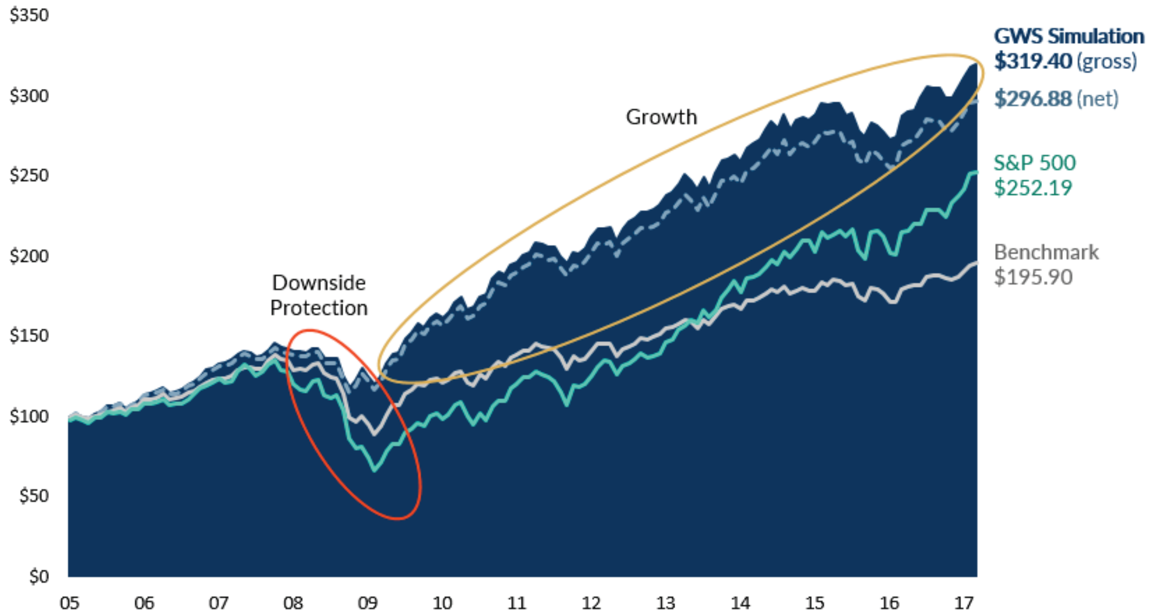
The Benefits of Paritas' Global Wealth Strategy

With all the different types of risks that challenge investors around the world, it's important that you have a manager on your side that understands and manages these risks in a systematic and disciplined way.

Constructing a portfolio strategy that offers investors consistent returns while protecting capital from sharp market declines, Paritas offers a compelling value proposition.

In the table below, we show the Paritas GWS model's simulated results compared with the S&P 500 equity market and the benchmark representative of the traditional 60/40 balanced portfolio described earlier in the opening paragraphs.

Notice how during the 2008-09 financial crisis and ensuing market collapse, the GWS simulated model protected capital. The simulated model portfolio was nearly 80% allocated to fixed income during that time. When the markets recovered in March 2009, the rebalancing allocations shifted gradually as the market rebounded, leading to strong appreciation over the course of the current bull market cycle.



As of March 31, 2017. Inception date January 2005. Source: FactSet.
The information provided regarding performance and returns of the Simulated Global Wealth Strategy portfolio described in this document are pro forma and may not be construed as actual results of such hypothetical portfolio. A pro forma 0.60% management fee was applied to the gross performance of the GWS simulation to arrive at net performance.

The results are impressive; the simulated balanced risk portfolio significantly outperformed, primarily because the portfolio has a strong risk management philosophy. As the markets rebounded following the crisis, GWS was also able to produce appealing upside capture. The magnitude of the differential in "real" dollar terms was substantially higher.

Combining principles of common sense with diligent portfolio research and analysis truly paid off during this market cycle. We believe it's about time that more investors understood how a balanced risk portfolio could meaningfully improve the probability of achieving a successful outcome for their portfolios.

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