Part 3b: Managing Risk for Higher Returns: International Version

We wouldn't quite call this Part 4 of our strategy papers. It's more like Part 3b as it still falls under the same Managing Risk for Higher Returns umbrella that our domestic Drawdown-Managed Equity Strategy does, it just applies to stocks outside of the US.

Below we'll revisit the concept of managing risk for higher returns and why that matters today. If you've read the previous paper, some will be repetitive, but we believe it bears repeating, especially when it comes to international stocks as they are known to contain some volatility!

We will close with more specific discussion around our International Drawdown-Managed Equity strategy. It's a combination of pure exposure to developed and emerging market stocks, and a dynamic option strategy focused on providing compelling upside/downside capture ratio. More on that in a minute...

Managing Risk for Higher Returns

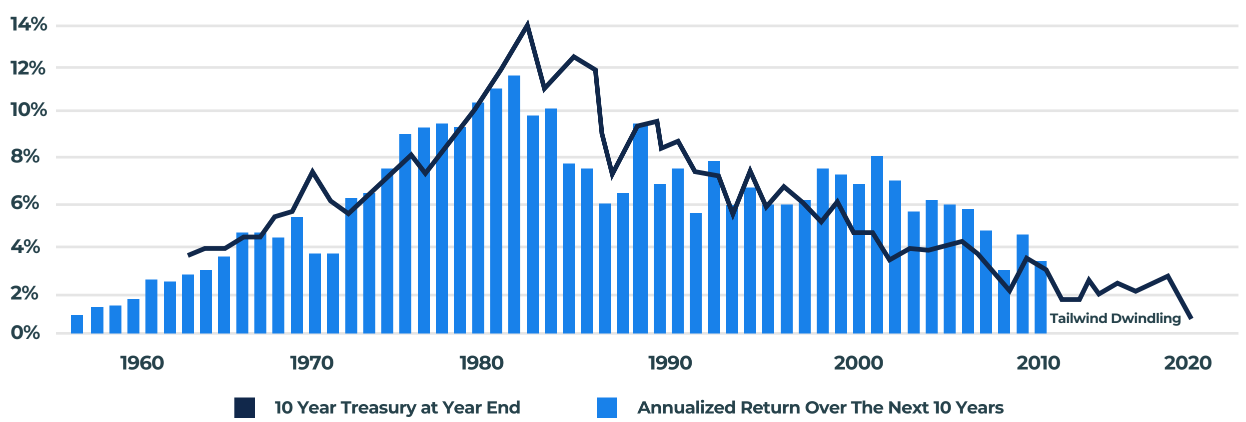
Look, we could make this complicated, but we're just going to be straight – we believe future returns for bonds look pitiful. As in, we expect a goose egg for real return. We can't guarantee that, but we'd argue your bonds' future is not bright. What has happened probably won't happen again, and that matters for the lifeblood of investors.

For the last few decades, bonds have ridden the wave of interest rates falling, significantly. Rates falling means bond prices go up. If we issue a 10 year bond paying 5% interest and then all of a sudden the going interest rate for 10 year bonds drops to 3%...that 5% paper we issued just got more attractive, prices go up. See how that works?

To summarize what bonds have done...they've crushed it. In some time frames over the last 20 years, the boring conservative bond portion of portfolios has outperformed their "risky" counterparts, stocks! They've done more than just provide stability and income, they've injected growth of capital as well.

Why are we talking about bonds? Because there are massive amounts of wealth invested in bonds. That wealth needs to generate return and has been able to rely on bonds for stability, income, and return in the past. Now, hopefully they provide stability, but income and return is highly questionable. Remember where rates are?

10 Year Treasury Note Yields Have Been A Solid Estimate For Future Returns



Source: Bloomberg, Aptus Research

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Return and the risk associated with it is what matters to investors. Can they generate enough return to maintain or improve the quality of life, retirement, or whatever the objective? And, just as important, can they handle the risk associated with those returns? How you get from point A to point B matters. Here's the problem:

We believe potential return is greater in stocks than bonds, but so is the movement. Bonds are a pony, saddled up with a lead line. Stocks are a wild stallion you're trying to ride bareback. The stallion can get you there faster, but you'd better hold on.

Over the next decade, we think investors need stocks for their plans to work out.

Now that the foundation is laid, let's look at how managing risk can allow for higher return. We're going to say this in more words below, but this is all you need to remember. To own more stocks and keep investors from bailing at the wrong time, you have to chop off their left tail.

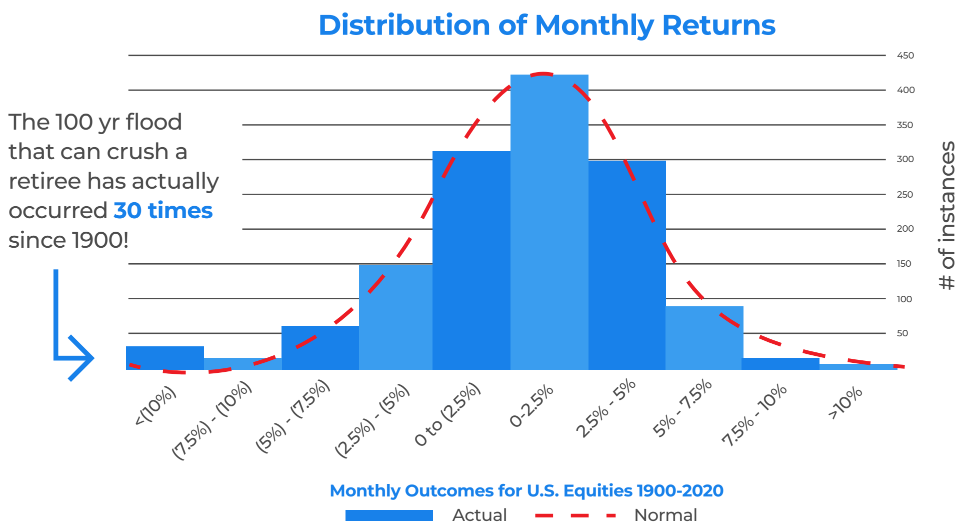
The two ways managing risk can lead to higher returns:

·Initial Asset Allocation
·Opportunistic Capital

Before we get into that, let's cover what we mean by chopping off stocks' left tail.

Left Tail Chop –Reducing Drawdown

Think back to Stats 101 and the normal distribution curve or a probability bell curve. Here's what that looks like for a visual:



Source: Robert Shiller, Aptus Research

In a perfectly normal distribution, you will have a whole lot of data points cluster around the center of the curve (the mean) and other data points scattered to the left and to the right where the curve gets closer and closer to the horizontal axis -those are the tails. There's a left and a right tail. In terms of stock returns, the right tail is where great returns show up, and the left tail is the ugly stuff, major drawdowns.

What's a drawdown?

Drawdown is the peak to trough decline in a portfolio's value. $1,000,000 turning into $500,000 is a 50% drawdown. Volatility can't be avoided, but panic-inducing drawdowns can be minimized by effectively chopping the tail!

For stocks, the curve is not perfectly normal. Stocks have a fat left tail. Meaning, the disastrous returns happen more than the good stuff. Owning more stocks exposes you to a great chance of experiencing the agony of left tail events.

Initial Allocation

This topic is the secret sauce to our portfolios. Don't tell anybody.

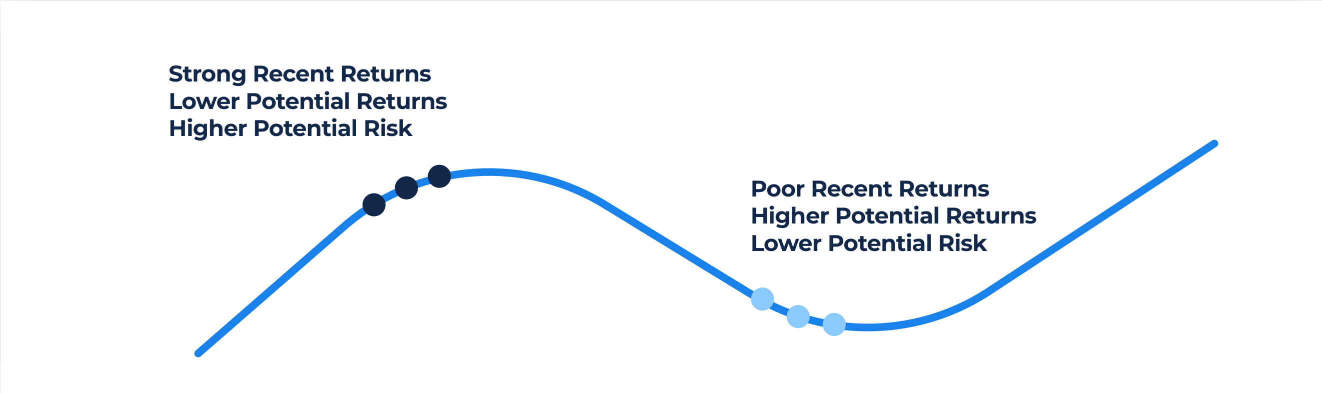
If we properly minimize our exposure to the left tail of stocks, it provides the ability to own more of the asset class with potential return (stocks), and less of the asset class that looks dead (bonds). More importantly, we can do so without exposing the portfolio, to outsized drawdown risk. Volatility is part of investing, and we can deal with that. It's the drawdown that keeps us up. Nothing blows up a plan quicker than drawdown.

We can't stress this enough -the increase of potential return to a portfolio, by owning more stocks than bonds, is amplified by the market we're in. We'd argue, future returns have never looked so bad for bonds.

We are able leverage our ability to hedge away drawdown risk to build in more potential return in our asset allocation decisions. Using risk for higher return.

Opportunistic Capital

We covered how we build in more potential return on the front end, but can we alter potential return during market turmoil? Let's use deductive reasoning. That's a fancy way of saying common sense. High valuations can lead to lower returns associated with higher risks (a bad combo) and low valuation can lead to higher returns associated with lower risks (a good combo).

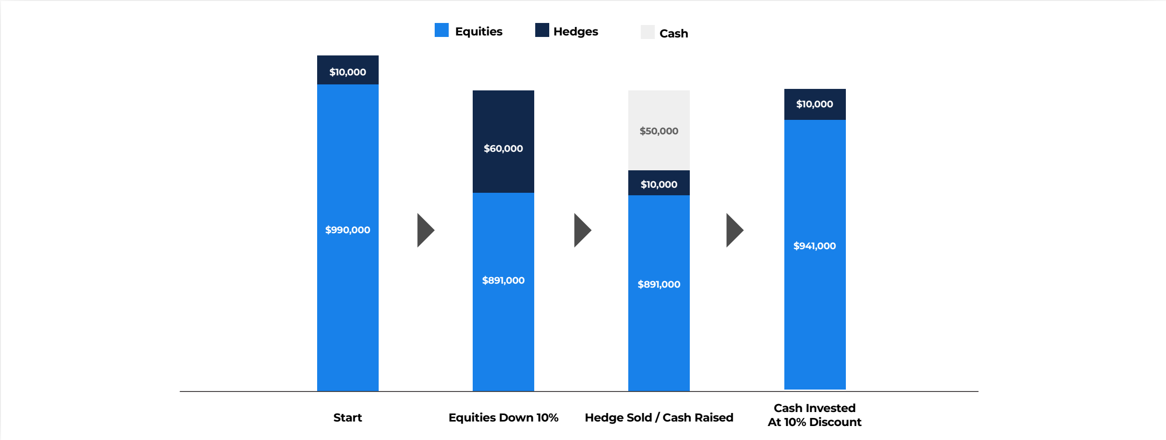


"Investors should pray for a market crash because it will allow them to buy at lower prices. When the opportunity to put capital to work is great!"

Yeah yeah, we hear you...but do investors really want a market crash? Maybe the 35 year old stashing away money monthly. ***Definitely not the 60 year old in or nearing retirement.***

Minimizing exposure to drawdown is a great first reason to deploy risk management, but an even more compelling reason is to create capital when the opportunity to deploy is at its greatest.

Think about why you are able to minimize drawdown. It's because what started as a small hedge can grow in value as markets drop. Converting this value to cash provides an opportunity to buy at lower prices, when future potential returns improve. More shares at lower prices, a good combo in seeking more upside capture when markets recover.



Source: Aptus Hypothetical Illustration

The above example is shown for informational purposes only and should not be interpreted as actual historical performance of Aptus Capital Advisors, LLC. Results are hypotheticaland do not reflect trading in actual accounts. The actual results of individual clients will differ due to many factors, including individual investments and fees, individual client restrictions, and the timing of investments and cash flows. Clients should not rely solely on this or any other performance illustrations when making investment decisions.

This allows advisors and clients to eliminate the need for attempting to time the market and gives them the chance to create capital when it's needed most.

While others are in a panic during market drawdown, you are altering potential return by opportunistically looking for areas to deploy freshly created capital. The second way you can use risk management as a tool for higher potential return.

Putting This Together

The concepts above are a primer on the things we think matter as it relates to efficiently compounding investor's capital. We want to deliver strategies that help alter the math of overall portfolios while avoiding large losses.

It's these concepts that underpin our International Drawdown-Managed Equity strategy which we position as the core international equity exposure in our portfolios.

This strategy consists of two things:

- Pure exposure to international developed and emerging market stocks through ETFs
- A flexible option strategy designed for left tail chop and a compelling upside/downside capture ratio

Our strategy provides access to international stocks with a blend designed to be roughly in line with the MSCI ACWI ex-US index. Rather than selecting individual equities, most of our exposure is gained through ETFs, providing efficient diversification ay an approximately 70/30 mix of Developed to Emerging.

While we find the current Yield + Growth characteristics of international stocks to be appealing on their own, we find it even more appealing when considering the valuation discount. That said, without the guard rails of hedging, it's been hard to justify putting too much capital at risk overseas.

This is where the options come in. We now have the flexibility to provide convexity in both tails along with long volatility exposure. Our strategy utilizes options for the following objectives:

Protection: In most environments, this strategy will utilize traditional hedges through puts and put spreads, for protection on 50% of the total value. In addition, we can utilize call options on the VIX itself. This VIX exposure is more of a tail hedge-type exposure.

Upside: We can utilize call options on one or more equity indexes or ETFs when we believe the need for right tail convexity is warranted. This feature provides for great upside capture when markets are rising, and the potential to reduce any drag of hedging.

Income: We have the option to write calls to generate income for the strategy. We anticipate selling calls mainly in elevated volatility environments as this could help fund our hedges.

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Naturally, we expect our Drawdown-Managed International strategy to trail when international markets are ripping straight up. What we sacrifice in short term upside, we believe we make up for through our risk management, and higher return potential at the asset allocation level. Not to mention the potential to create cash when opportunities present themselves.

The importance of upside/downside capture is our priority. Effective risk management and drawdown reduction creates amathematical advantage along with behavioral advantages towards the objective of compounding capital. Every strategy and portfolio we manage is focused on this. In an asset class known to demonstrate volatility, we believe our approach to international markets will be welcomed by investors and a great extension to our offerings.

Disclosures

An investor should carefully consider the investment objectives, risks, charges and expenses of IDME, as applicable, before investing. The prospectus for IDME contains this and other important information and is available free of charge by calling toll-free at 1-800-617-0004 or writing ACA at 265 YoungStreet, Fairhope, AL 36532. The prospectus should be read carefully before investing.

Drawdown is defined as the peak-to-trough decline for an investment during a specific period. A call option gives the owner the right to buy the underlying security at the specified price within a specific time period. A put option gives the owner the right to sell the underlying security at the specified price within a specific time period. The Cboe Volatility Index (VIX) is a real-time index that represents the market's expectations for the relative strength of near-term price changes of the S&P 500 index (SPX). The Morgan Stanley Capital International All Country World Index Ex-U.S. (MSCI ACWI Ex-U.S.) is a market-capitalization-weighted index maintained by Morgan Stanley Capital International(MSCI). It is designed to provide a broad measure of stock performance throughout the world, with the exception of U.S.-based companies. The MSCI ACWI Ex-U.S. includes both developed and emerging markets.

Investing involves risk; Principal loss is possible. The Funds are non-diversified, meaning they may concentrate their assets in fewer individual holdings than diversified funds. Therefore, the Funds are more exposed to individual stock volatility than diversified funds.The Funds may invest in options, the Funds risk losing all or part of the cash paid (premium) for purchasing put and call options. The Funds' use of call and put options can lead to losses because of adverse movements in the price or value of the underlying security, which may be magnified by certain features of the options. The Funds' use of options may reduce the ability to profit from increases in the value of the underlying securities. Derivatives, such as the options in which the Funds invest, can be volatile and involve various types and degrees of risks. Derivatives may entail investment exposures that are greater than their cost would suggest, meaning that a small investment in a derivative could have a substantial impact on the performance of the Funds. The Funds could experience a loss if its derivatives do not perform as anticipated, the derivatives are not correlated with the performance of their underlying security, or if the Funds are unable to purchase or liquidate a position because of an illiquid secondary market.

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