OPINION

ENJOYING THE RIDE

TACTICAL SECTOR INVESTING

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A good military strategy is a tactical one, but our armed forces aren't the only ones to use a tactical strategy. As financial professionals, we use them too. Tactical Asset Allocation is an active management portfolio strategy that shifts the percentage of assets held in various categories to attempt to take advantage of market pricing anomalies or strong market sectors.

Tactical allocation using sector investing and relative strength can provide a range of benefits for investors looking to optimize their portfolio returns. In this approach, investors focus on selecting individual sectors and industries that believe they will perform well in the current market environment, and then use relative strength analysis to compare the performance of these sectors to the broader market.

Much like a good tactical strategy can plan for various scenarios, a potential benefit of tactical allocation is the ability to take advantage of changing market conditions. Rather than simply holding onto investments for the long term, tactical investors can adjust their holdings as market conditions shift. For example, during periods of economic expansion, sectors such as technology and consumer discretionary may perform well, while defensive sectors like utilities and consumer staples may lag. By using relative strength analysis, investors can identify the sectors that are likely to outperform and adjust their holdings accordingly.

Tactical allocation may have the potential to provide higher potential returns compared to passive investing. By actively managing their portfolio and shifting holdings based on market conditions, investors can potentially capture higher returns during periods of market growth while reducing exposure during periods of decline. Additionally, by focusing on individual sectors and industries, investors may be able to identify opportunities for outperformance that could be missed by a more passive approach.

Of course, as with all investing, tactical allocation does come with some risks. For example, it can be difficult to consistently predict which sectors or industries will outperform in any given market environment. Additionally, active management can lead to higher trading costs and taxes, which can eat into returns over time.

For many years, investors have employed sector rotation strategies, which have become more popular with the rise of exchange traded funds, allowing for more efficient sector exposure. Rather than relying on stock-picking, sector rotation strategies aim to capitalize on broad industry trends. Momentum is a popular way to analyze sectors, with many investors using a simple moving price window to rank potential investments based on their performance over a set period of time. This approach is objective and does not require extensive knowledge of each sector. Sector rotation strategies can potentially provide a good performance over longer time horizons, and momentum is an easily back tested factor using simple rules. Using data from the Ken French Data Library on 48 industry groups dating back to the 1920s, we can analyze the performance of sector rotation strategies and the associated risks for investors seeking returns.

A ranking system using price performance relative strength of sectors can provide a manageable way to allocate assets to the areas of the market which appear to be performing well and attempt to add an extra layer of downside risk management we can include a cash alternatives index allocating to cash when it is highly ranked.

Overall, tactical allocation using sector investing and relative strength can be a powerful tool for investors looking to optimize their portfolio returns. By focusing on diversification, flexibility, and the potential for higher returns, this approach can help investors achieve their financial goals while striving to minimize risk and allowing you to enjoy the ride.

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