OPPOQUEST
REGISTERED INVESTMENT ADVISOR

3318 Shadow View Ln
Missouri City, TX 77459
Tel: 281 969 8380

February 05, 2020

"CASH IS TRASH"

For the second time in three years, famed money manager, Ray Dalio, made headlines at the annual elite confab in Davos called *World Economic Forum*. Interestingly, like in 2018, this time also he pronounced that cash was a poor investment choice. Only difference – last time he said investors holding cash would feel "stupid" and this time he was less offensive by declaring that "cash is trash." The last time he dismissed cash on January 23, 2018, things didn't turn out that well. Equity markets sold off roughly 10% in under two months and by roughly 16% by December 17, 2018. We are keeping our fingers crossed for him this time around.

To be clear, we remain avid admirers of Mr. Dalio and eagerly follow his views on the markets. So, our intention here is not to call him out for making that unflattering call in 2018 or imply that a freak coincidence is likely about to unfold. Rather, we want to focus on the tactical idea of holding cash at times when risk assets are flying high. Using the same episode of early 2018 when equity markets were at multi-year highs, we calculate that holding 10% cash prior to the decline and tactically deploying it in the sell-off would result in a gain of +1% if we were to pick the absolute bottom and the market recovers to the original level. Of course, it is impossible to do that consistently. So, we assume half the contribution – i.e. 0.5% return increase. And if we can repeat that process just once every year for 10 years and assuming average annualized return of 5%, a portfolio of $100,000 employing such tactical trading will be ahead by $6,300 over a portfolio that does not employ tactical trading. We think that is meaningful especially in an era where the frequency of big volatility spikes is getting lesser but the range of the occurring episodes themselves is getting wider.

We understand that the tactical trading described above might seem similar to *Market Timing* which we have emphatically rejected in the past. The difference between the two is the intent – market timing relies more on the idea of mean reversion while tactical trading that we are advocating relies on managing risk of individual positions in a portfolio. As we pointed out in our 2H17 update (Fear of the Known), selectively trimming positions as they move beyond the intended size reduces risk and also reduces portfolio volatility when required most. Needless to say, we are strong advocates of tactically using cash in investment strategies. As of the writing of this update, we have between 8-12 % cash buildup in our strategies. We hope Mr. Dalio is right and markets continue to move higher as our still healthy risk exposures should provide corresponding up-side. But just in case he is not, we would not only be putting our cash holdings to very good use but also be wondering at the odds of him getting the same call wrong at the same place - twice!

Performance Review

We have recently renamed our investment strategies to better align them with the risk profiles that they are benchmarked against. Here are the changes:

Previous Name	New Name	Benchmark
CORE	GROWTH	S&P Target Risk Growth Index
CONSERVATIVE	MODERATE	S&P Target Risk Moderate Index
CONSTRAINED	CONSERVATIVE	S&P Target Risk Conservative Index

Below is the summary of the performance of our strategies for 2H19:

OppoQuest Strategy	2H19 Strategy Returns (Gross)	Strategy Benchmark	2H19 Benchmark Returns	Outperformance / (Under-performance)
GROWTH	4.54 %	S&P Target Risk Growth Index	6.52%	(1.98%)
MODERATE	5.35%	S&P Target Risk Moderate Index	5.25%	+0.10%
CONSERVATIVE	5.77%	S&P Target Risk Conservative Index	4.61%	+1.16%

Growth strategy

After an exceptionally strong first half of 2019, OppoQuest's GROWTH strategy (GROW) underperformed its benchmark for the 2H19 by a relatively small margin of 2% compared to the 1H19 outperformance of around 8%. Sector perfor-mances were mixed with Financials, Technology, and Precious Metals making positive contributions while Energy and Commodities continued their negative trend.

The top positive individual contributor was ROKU (+1.70%) which rose over 40% in the 2H19 after rising a mind-boggling 200% in 1H19. Market's confidence in its growth potential is increasing amid rising subscriber count which was close to 37 million at the end of the year – that is an addition of 7 Million subs in 6 months! We also think the advertising catalyst for ROKU's platform is just beginning to unfold and should become a big driver of the story in the years ahead despite fierce competition from Fire TV (Amazon) and Android TV (Google). We continue to maintain a full-sized position in ROKU.

NOK was the top negative contributor (-0.63%) for the second consecutive half as the stock slid around 25%. In late October, NOK cut its margin and cash flow guidance for 2019 and 2020. Worse, it suspended the dividend that was providing some floor to investors who were patient with NOK's recovery efforts and the promise of 5G. We are very disappointed not so much with the dividend cut but with the margin guidance and the additional capital investments required to make their product lines more competitive – factors that we were given to understand were already in place. Despite our hugely positive outlook for 5G and NOK's positioning as one of the only three major vendors, we have initiated hard stops as part of our risk management process that are based on technical factors as clearly the fundamentals are in a state of flux at NOK.

Moderate Strategy

OppoQuest's Moderate strategy (MODR) continued its outperformance trend into 2H19. While the outperformance margin was negligible, it did come on top of the 7% outperformance in 1H19. Similar to GROW, sector performance was mixed with Technology, Financials, and Precious Metals contributing positively while Commodities and Energy detracted.

First Trust Technology Dividend Fund (TDIV) was the top contributor again this half (+1.21%) with the fund rising close to 9%. As mentioned in our last update, this fund's constituents are large-cap dividend paying technology companies such as MSFT, INTC, TXN, CSCO & APPL most of whom continue to remain in favor. While we like the fund, we are looking for opportunities to get more targeted exposures. Recall that we had already initiated a position in MSFT during the selloff late last year and have identified few other stocks that will eventually replace this fund.

Like in GROW, NOK was the largest drag on performance (-0.83%) here as well and the earlier explanation and actions with respect to NOK are applicable to this strategy too.

Conservative Strategy

OppoQuest's CONSERVATIVE strategy (CNSR) had the best performance numbers with an outperformance margin of slightly over 1% versus its benchmark. As in other two strategies, sector performance was mixed with Financials and Technology contributing positively while Energy detracted.

Invesco KBW Bank ETF (KBWB) was the top positive contributor (+1.48%) for this strategy as the fund rose by around 13% in the half. This ETF gives significant exposure to the money center banks and has been one of the strategy's core holdings. Despite the concerns of low interest rates on banks' net interest margins, we remain constructive because banks have other levers of profitability to pull such as cutting costs through digitalization of branch banking services and increasing fee income through bundling more products and services. The most important catalyst for them, however, remains the capital return story. Dividends for most of them have been consistently rising and so have the buybacks. Barring a major setback to the economy, we expect that trend to continue.

On the negative side, Global X MLP and Energy Infrastructure ETF (MLPX) was the biggest drag (-0.18%) on performance although the impact on overall performance was marginal. The U.S. Energy Midstream sector has been lackluster and rangebound for quite some time now despite positive steps taken by managements of the industry constituents to improve profitability and strengthen balance sheets. While it is frustrating to see the market's disinterest of this sector, we think participants will eventually start pricing in these positive developments. Meanwhile, the approximate 7% yield of MLPX provides decent valuation support and attractive compensation for patient investors.

Outlook

We have not seen the outlook for risk assets being this bright since the financial crisis. Many of the earlier uncertainties such as the passage of USMCA, agreement over a US-China trade deal, the resolution of Brexit impasse, and the congressional approval of a budget deal have all been successfully completed. The biggest of all threats – a self-aggrandizing FED determined to impose its thinking on the markets – has also receded because it has indicated of late that it will support the economic expansion for the foreseeable future and not worry about hypothetical risks. The sky could not be bluer!

If we were forced to mention some risk for the market, it would be that China is witnessing some sort of a virus outbreak that has the U.S. concerned enough to ban all international flights coming from China on January 31, 2020. While we understand the need of this highly preemptive action from the Trump administration, we do not think it will last long. Experience of such outbreaks in recent times namely SARS, EBOLA, and SWINE FLU suggests that they get contained in a fairly short period of time.

So, given such a constructive environment for risk-taking, one would expect us to load up on risk. But we are not. Instead, we are shedding risk incrementally. The reasoning is quite simple – if the skies are so spotless blue, then the next event by default is going to be the emergence of a dark cloud. In other words, we don't think this perfect risk-taking environment will last too long.

We fully appreciate the risk that the *dark cloud* may take a while to emerge and we might be giving up some upside by turning cautious early. It is a valid concern and we would like to address it by pointing to two aspects of our action. First, we are only going to shed risk *incrementally* which means we will be invested throughout the current rally for most of its duration. At present, we have built up around 10% cash in all our strategies which means we are still 90% invested. And second, our experience and discipline inform us that the best time to sell is when most participants are convinced markets will continue to push higher indefinitely.

While we do not know how long this rally will last, we do know that it will not last forever. We may sound old-fashioned, but protecting downside in any investment strategy is unlikely to go out of fashion anytime soon.

For OPPOQUEST
PARESH JAIN
Founder & Portfolio Manager