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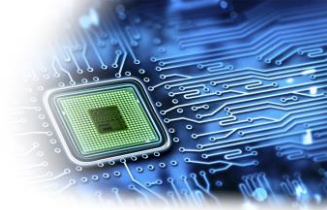
## **Navigating a USD Bear Market with Equity Factors**

Knowledge Leaders Strategy

Mid-Quarter Special Report February 27, 2018



KNOWLEDGE LEADERS CAPITAL



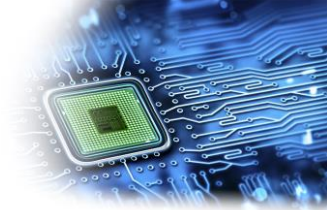
## Summary

The US Dollar appears to have entered a new bear market. Historically, the best economic barometer for the US Dollar is the net savings rate as a percent of GDP. Net savings are set to plunge with new fiscal stimulus.

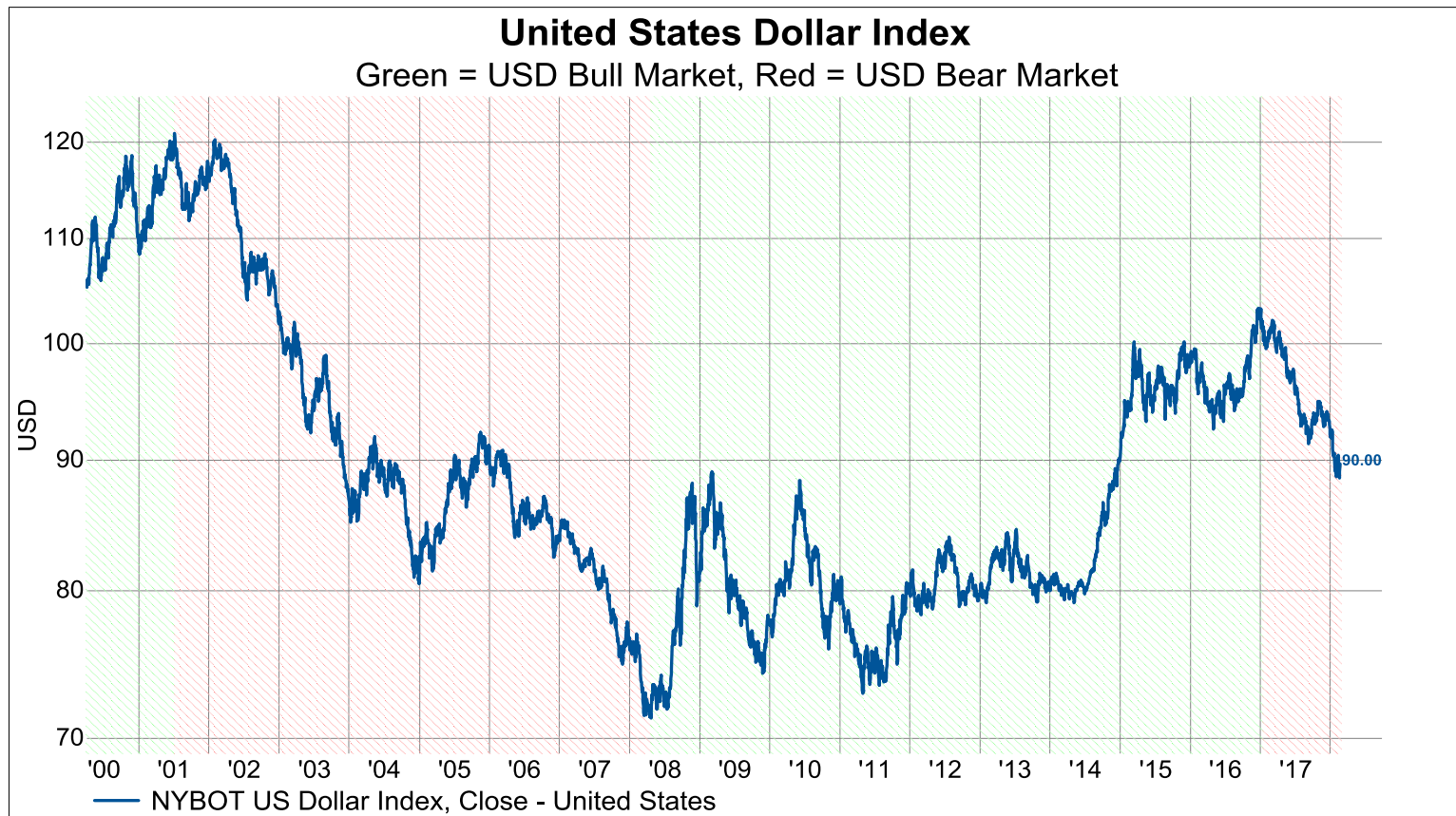
During the last two USD bull markets, foreign stocks underperformed US stocks. Smaller companies in the developed world tend to outperform larger companies in USD bear markets. Value stocks in the developed world outperform growth stocks during a USD bear. Low volatility stocks tend to underperform during USD bear markets. Momentum stocks in the developed world outperform more in a USD bull market but also do well in USD bear markets. High quality stocks underperform during USD bear markets.

Our Knowledge Leaders Developed World Index—representative of the Knowledge Factor—historically outperforms in both USD bull and bear markets due to its large exposure to foreign companies and its tilt toward smaller companies.

**We would favor Knowledge Leaders due to their consistent relative outperformance.** We would also favor foreign companies over domestic, value over growth and smaller over larger as we move further into a USD bear market.

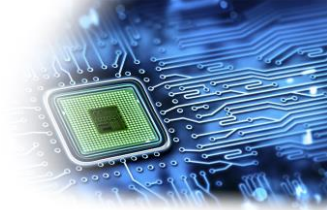


The US Dollar appears to have entered a new bear market. In this presentation we'll explore the equity allocation ramifications looked at through the lens of "factors."

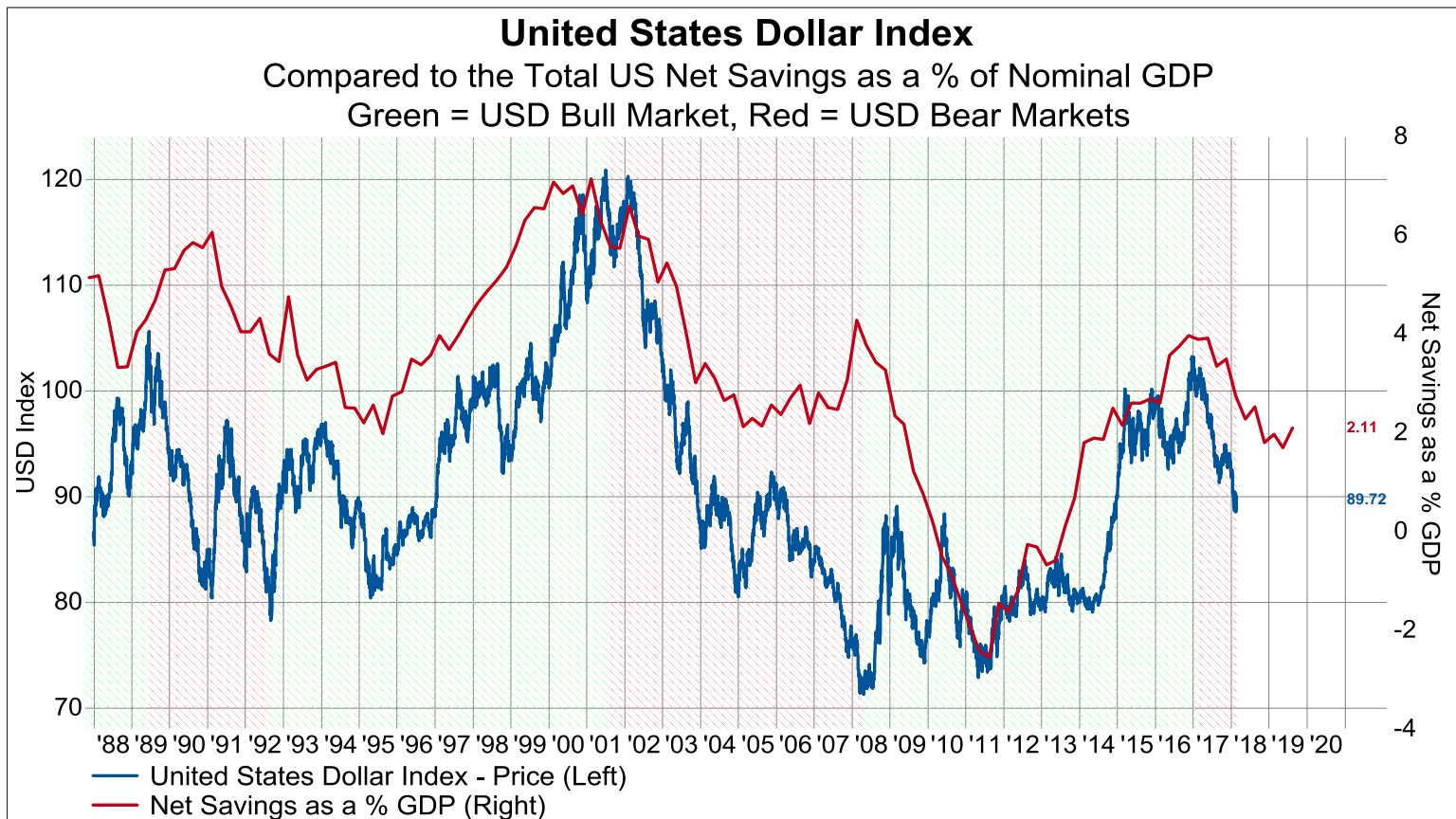


Date: 3/31/2000 - Present

Source: Factset

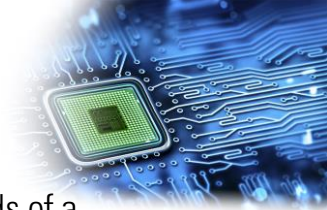


Historically, the best economic barometer for the US Dollar is the net savings rate as a percent of GDP. This captures aggregate net savings of the household, corporate and government sectors. Net savings are set to plunge with new fiscal stimulus.

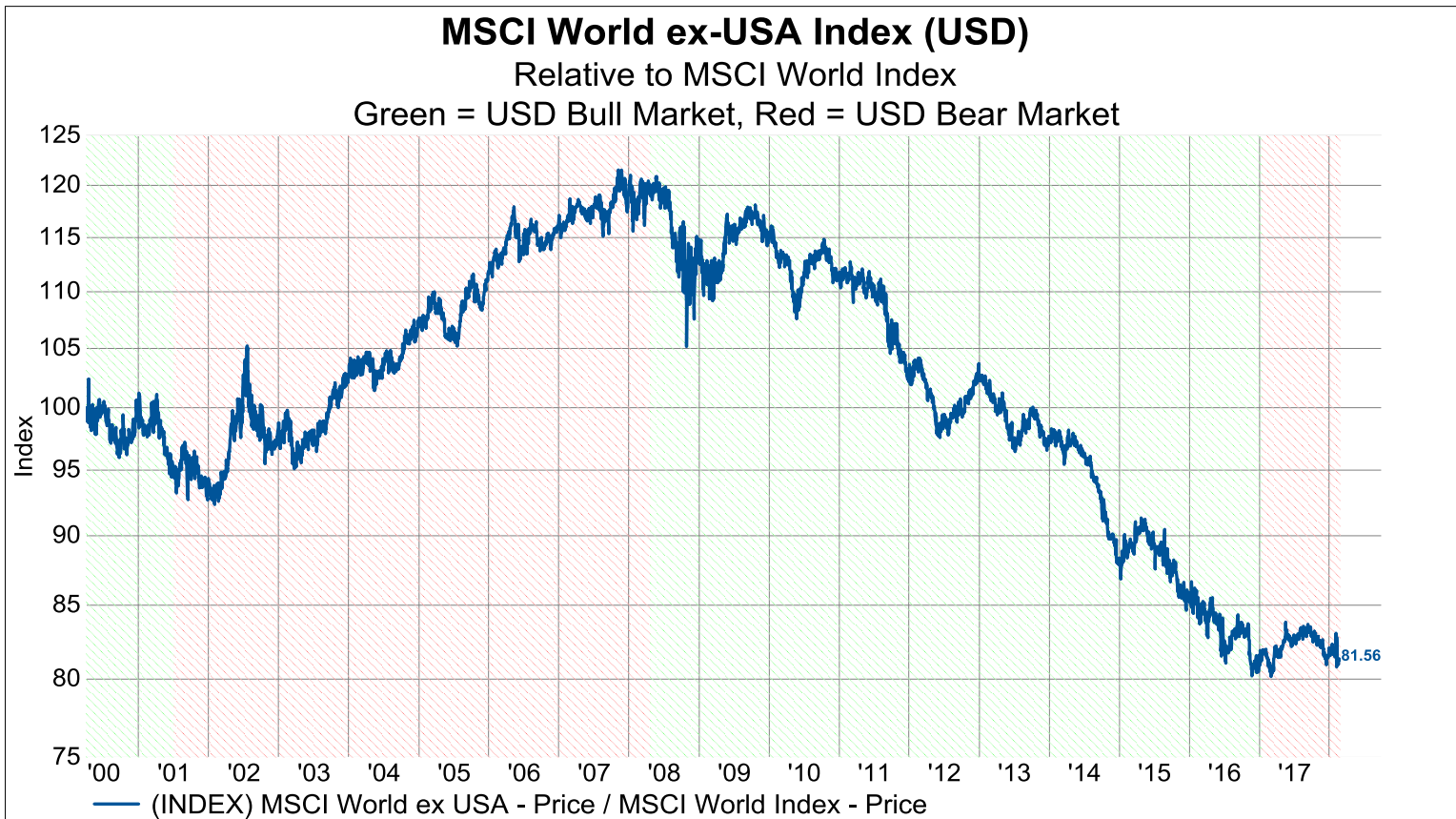


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Source: Factset

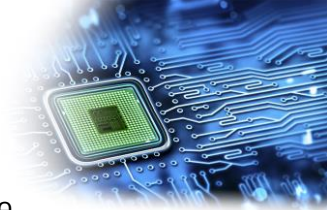


During the last two USD bull markets, foreign stocks underperformed US stocks. Similarly, during periods of a USD bear market, foreign markets outperformed US markets. The MSCI World ex-USA is a market cap weighted index of mid/large cap foreign companies.

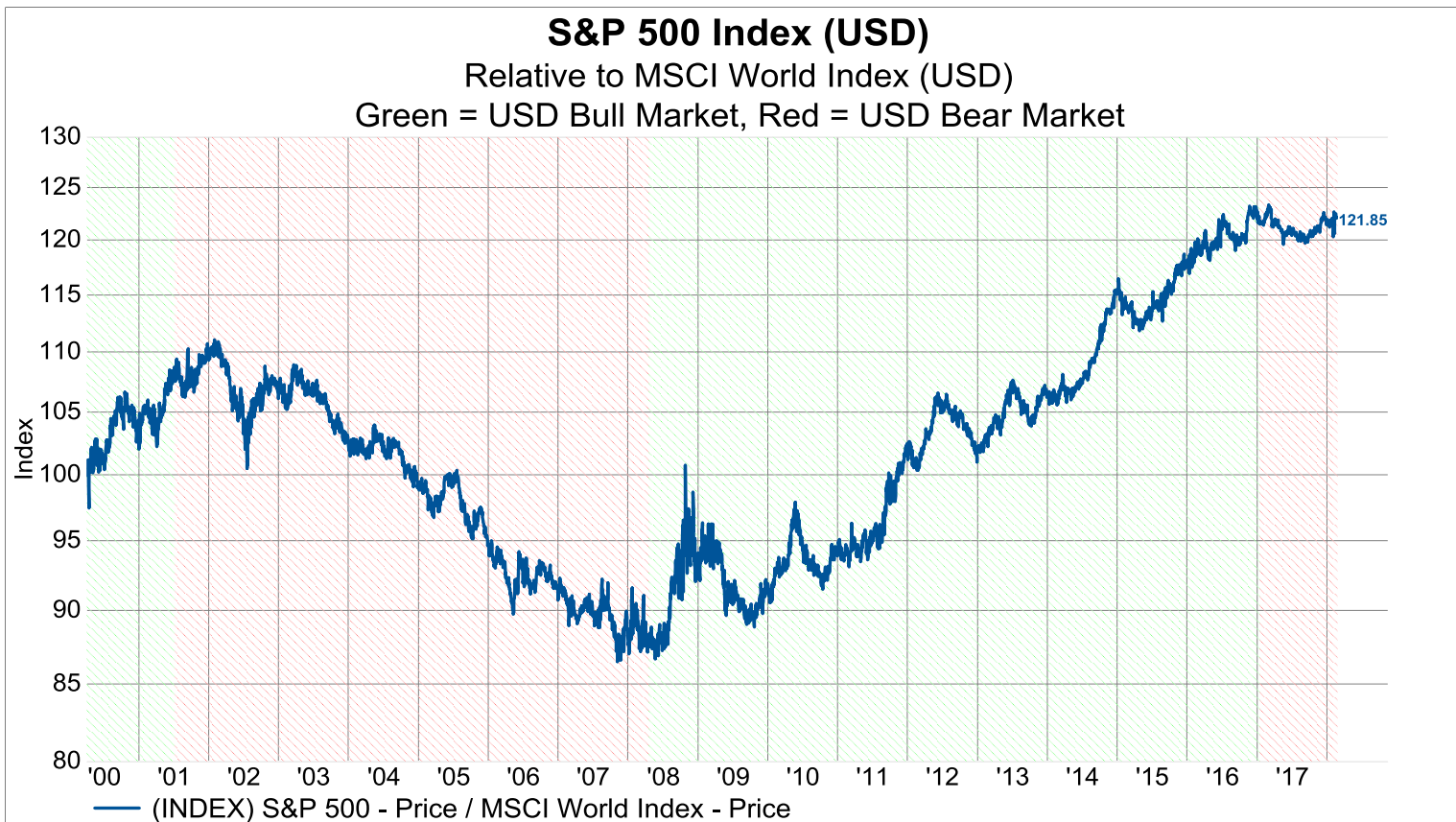


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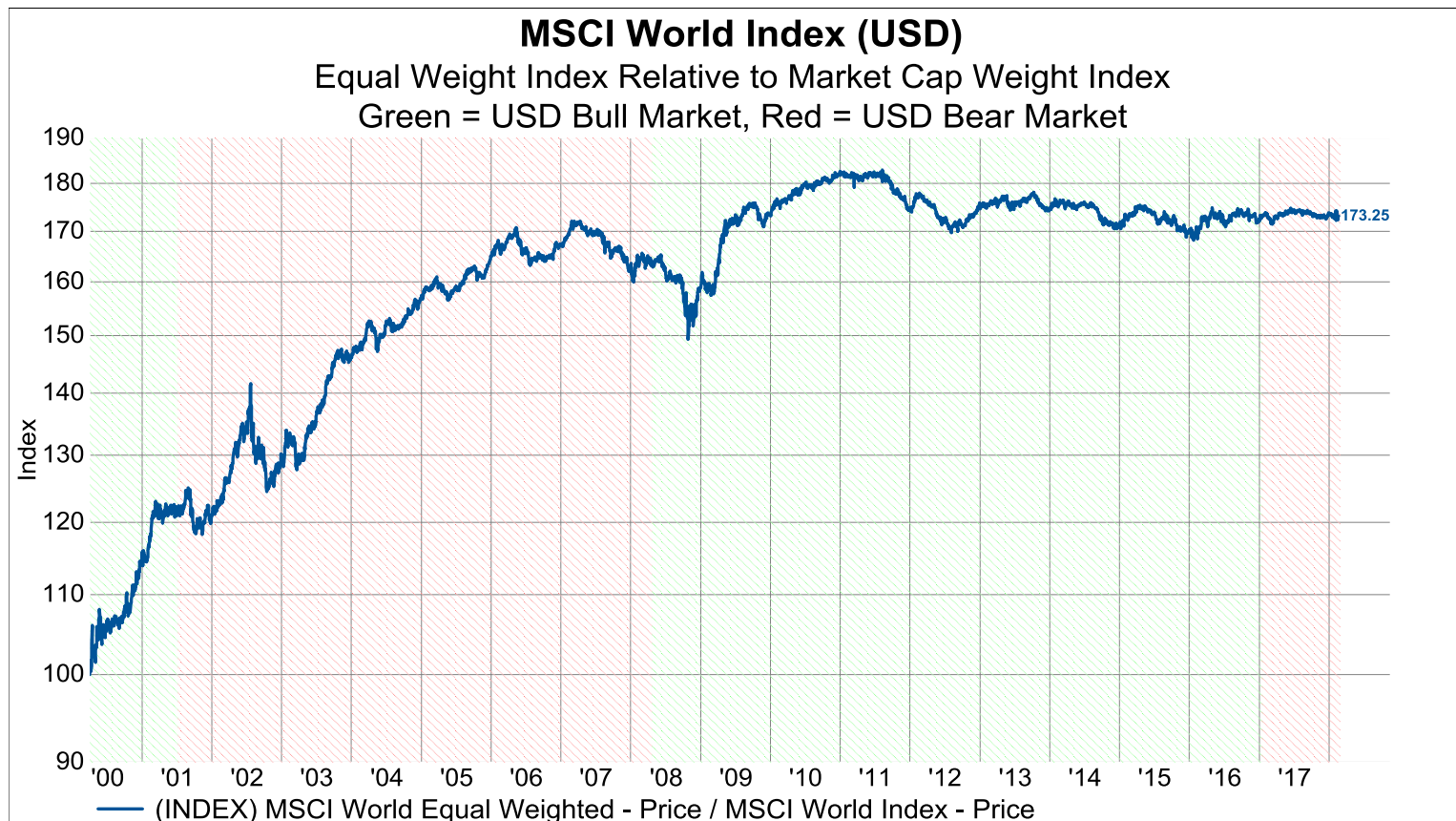
The S&P 500 displays clear performance characteristics in USD bull and bear market phases. Cumulative relative performance since 2000 in USD bear markets is -20% while performance in USD bull markets is +45%.



Source: Factset



We use the MSCI World Equal Weight Index as a proxy for smaller companies. Smaller companies in the developed world tend to outperform larger companies in USD bear markets. In the 7/6/2001 – 4/22/2008 USD bear market, smaller companies outperformed by +45%.

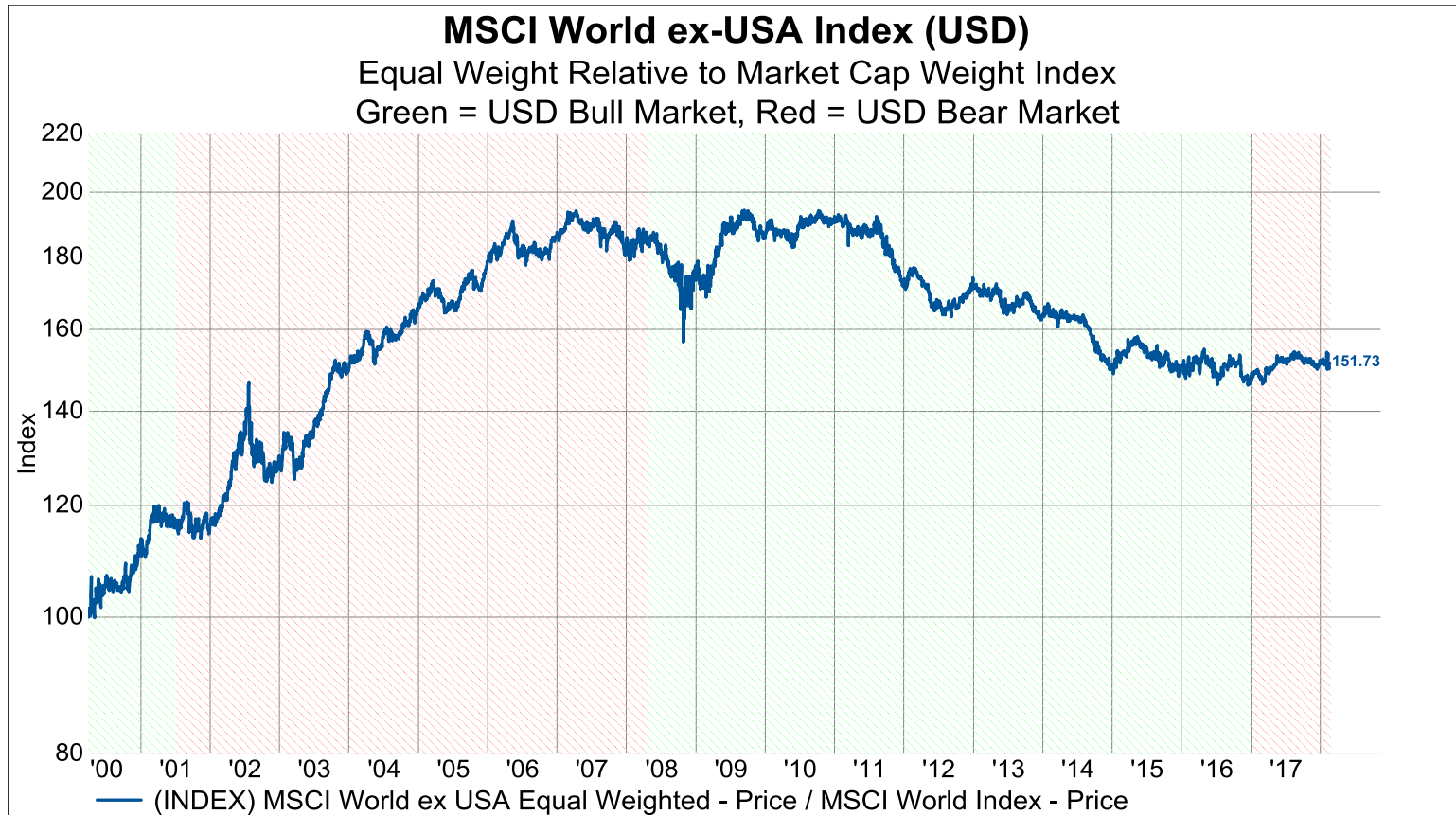


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Source: Factset



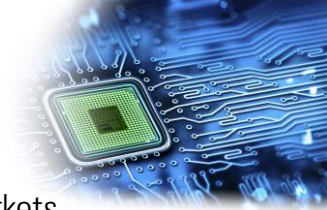
The MSCI World ex-USA Index shows the same behavior. In USD bear markets, smaller foreign companies tend to outperform larger ones. In the 7/6/2001 – 4/22/2008 USD bear market, foreign smaller companies outperformed by +65%.



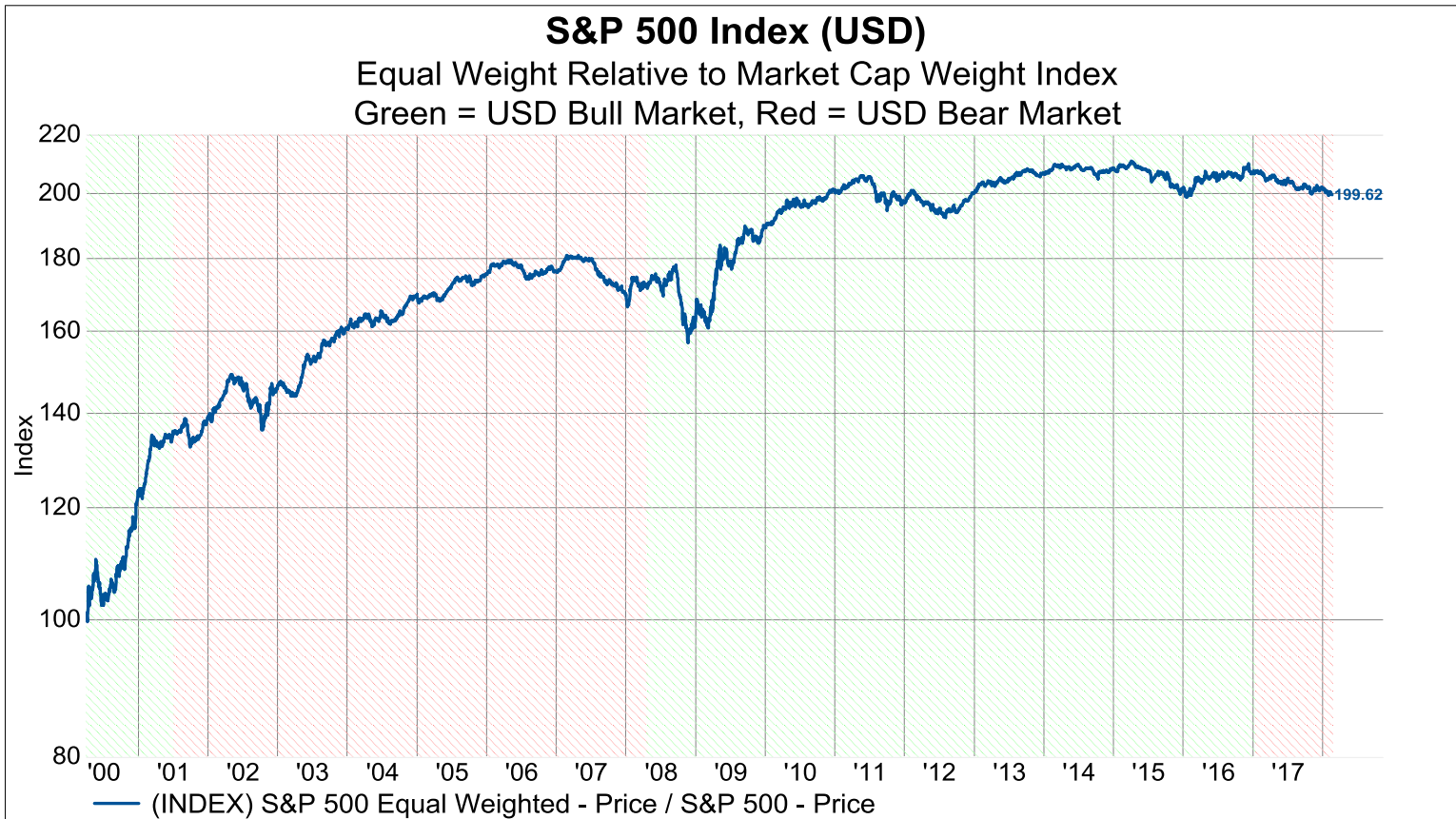
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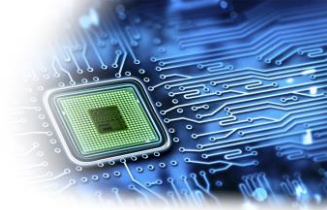


The same phenomenon of smaller companies outperforming played out in the US also. In USD bear markets, smaller companies in the S&P 500 tend to outperform their larger peers. The recent outperformance of the equal weight index validates the new currency regime.

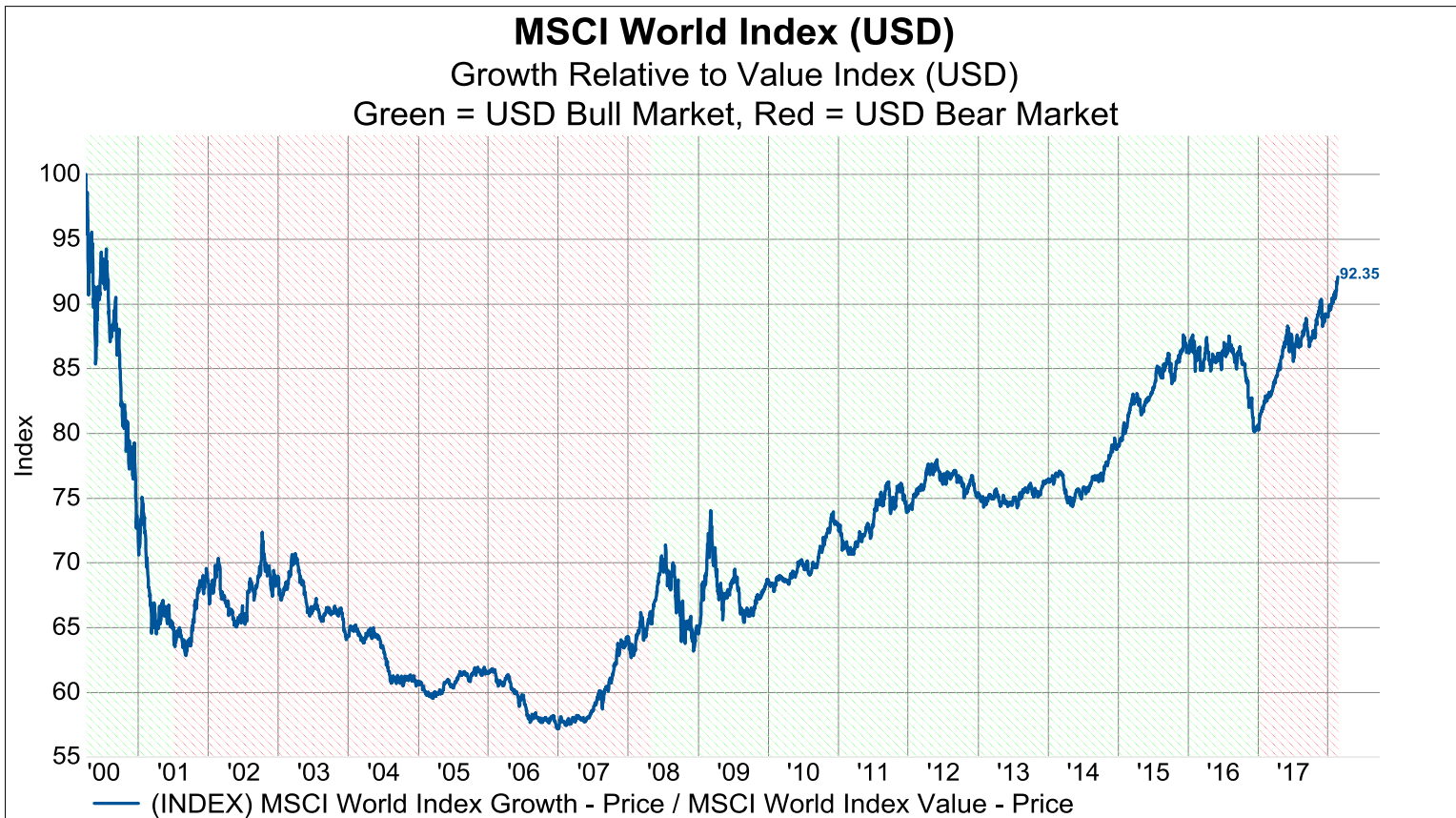


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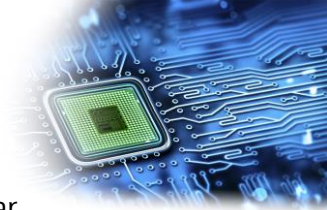


Turning to the style factor, growth stocks in the developed world outperform during a USD bull market and underperform in a USD bear market. So far, growth stocks have held on, but history suggests a rotation in relative performance.

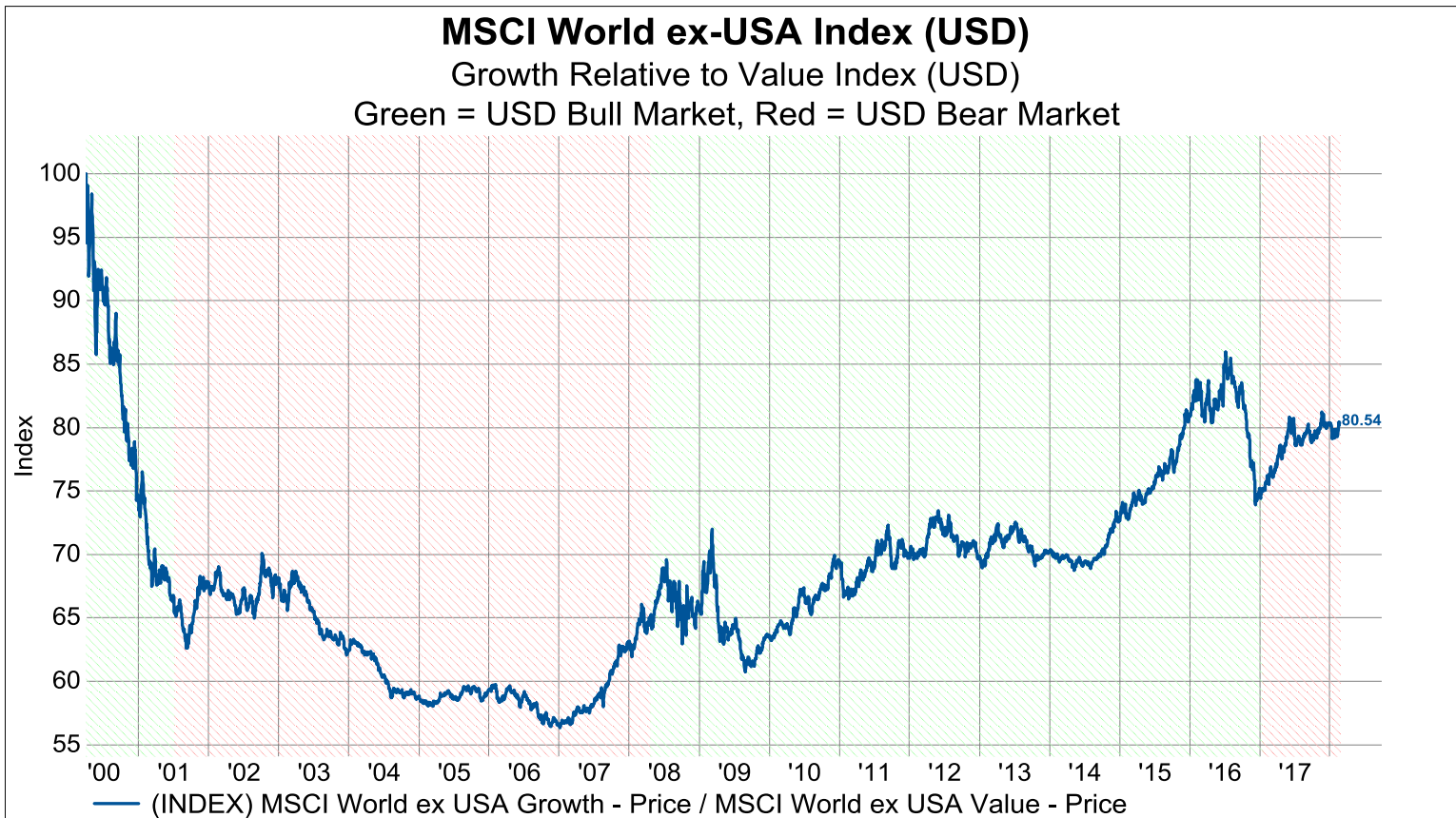


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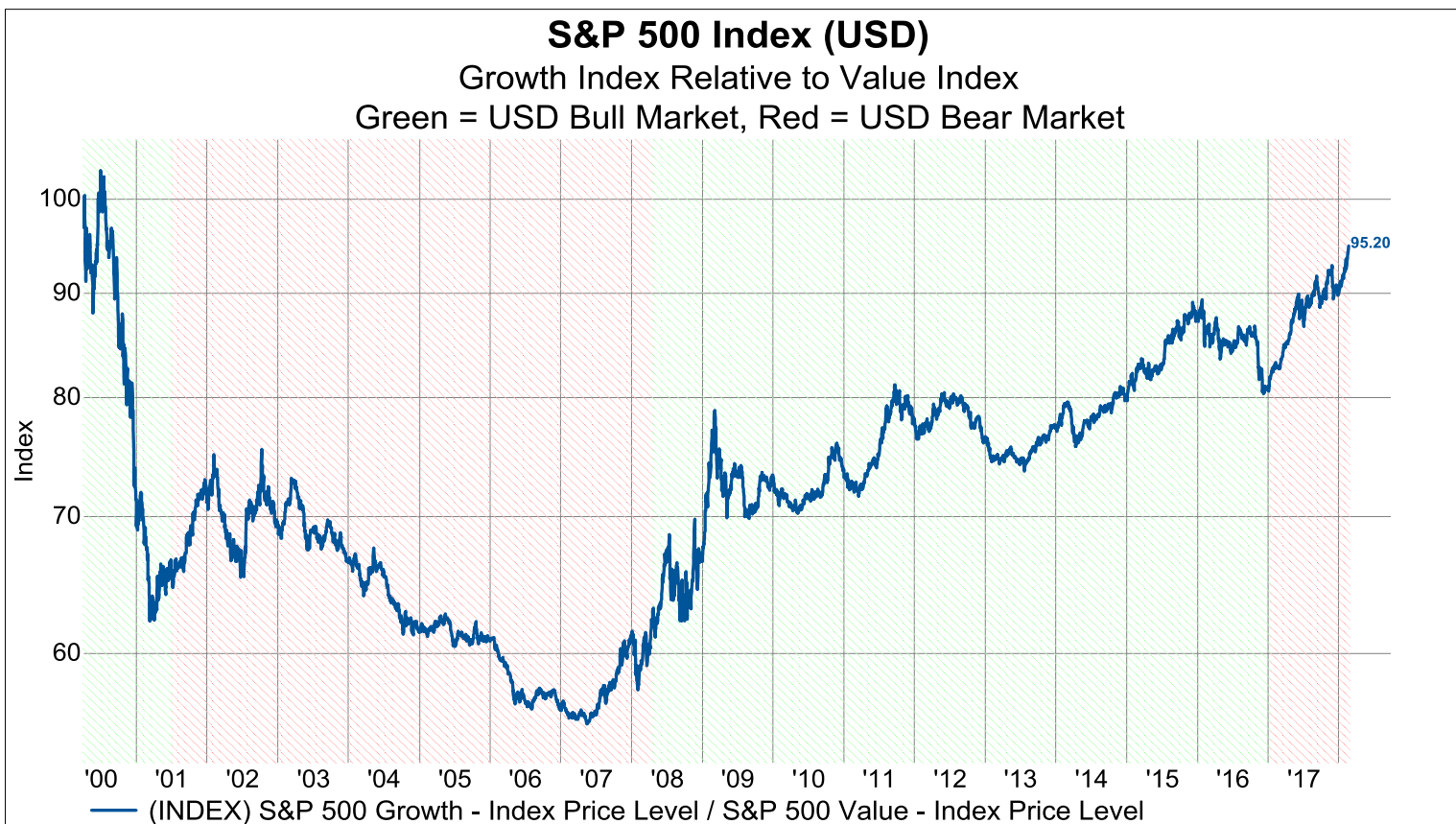
Foreign growth stocks tend to outperform during a USD bull market and underperform during a USD bear market. The recent turn in the relative performance of foreign value relative to growth stocks is supportive of the notion that we have entered a new USD bear market.



Source: Factset



The same phenomenon of growth stocks outperforming value during USD bull markets occurs in the US. Growth stocks outperformed value stocks by over 25% in the most recent USD bull market. We would expect the relative performance of growth stocks to fade this year.

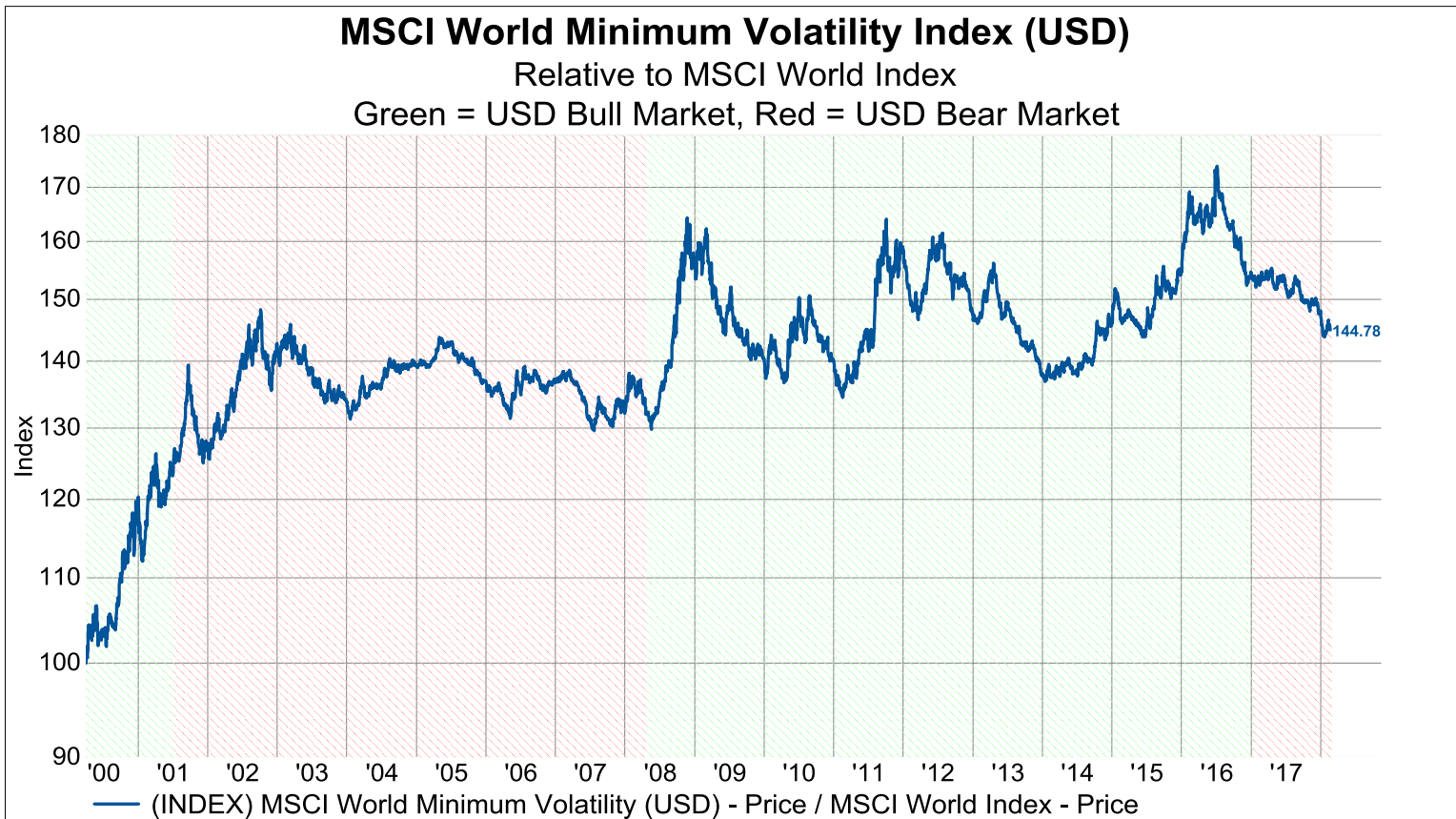


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Source: Factset



The MSCI World Minimum Volatility Index is a good proxy for lower beta stocks. It tends to outperform during USD bull markets. The cumulative outperformance during USD bull markets is +45%, compared to cumulative outperformance of -5% during USD bear markets.

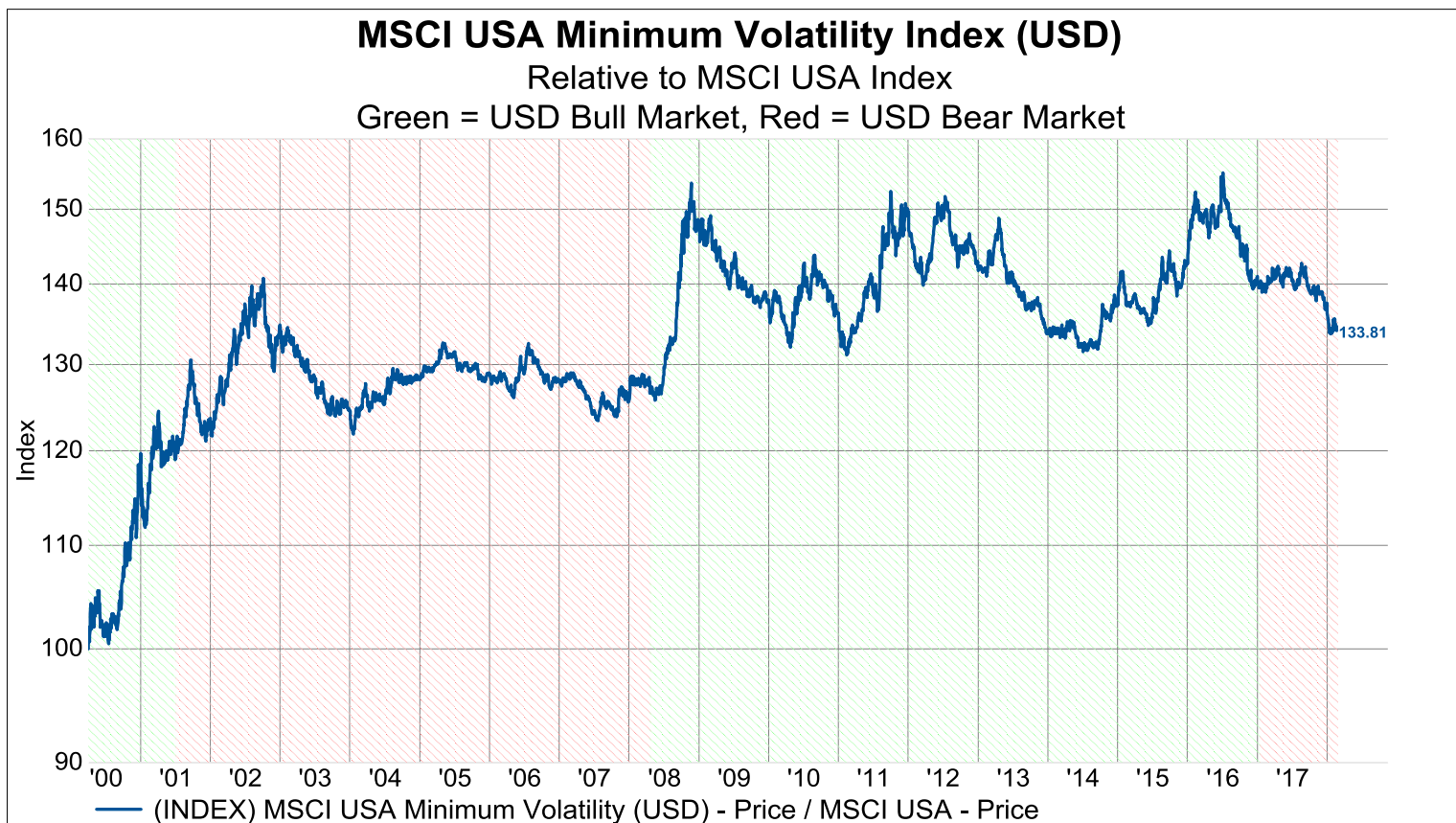


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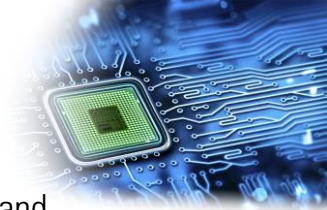


US lower volatility stocks similarly tend to outperform during USD bull market phases. The cumulative relative outperformance in USD bull markets is +40% while the cumulative relative outperformance is -5% during USD bear markets.

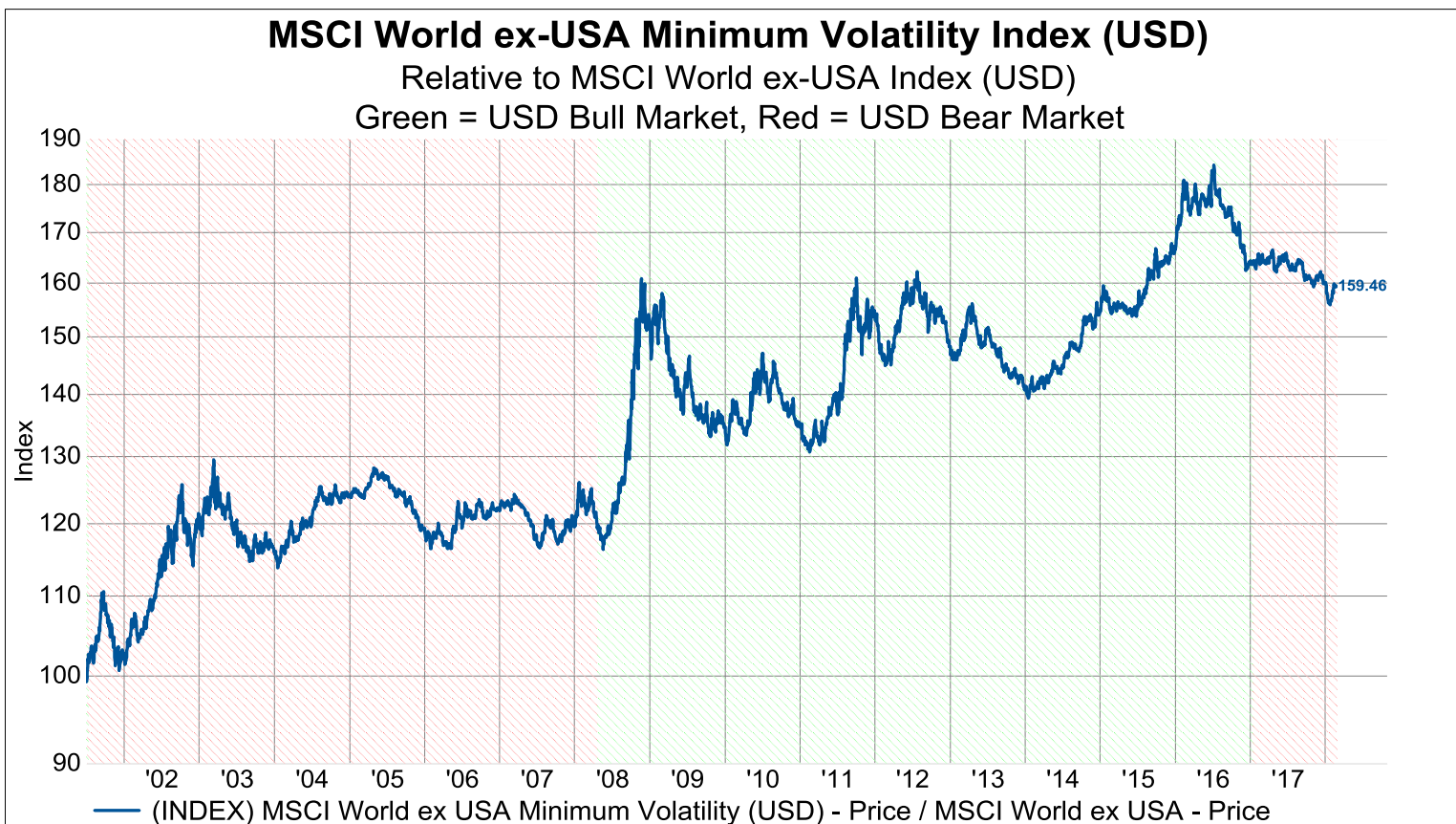


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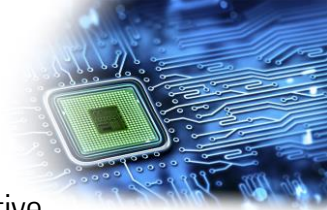


Foreign lower volatility stocks display the same characteristics, outperforming during USD bull markets and underperforming during USD bear markets. The history for the index is slightly shorter, but cumulative performance during USD bull markets is +45%.

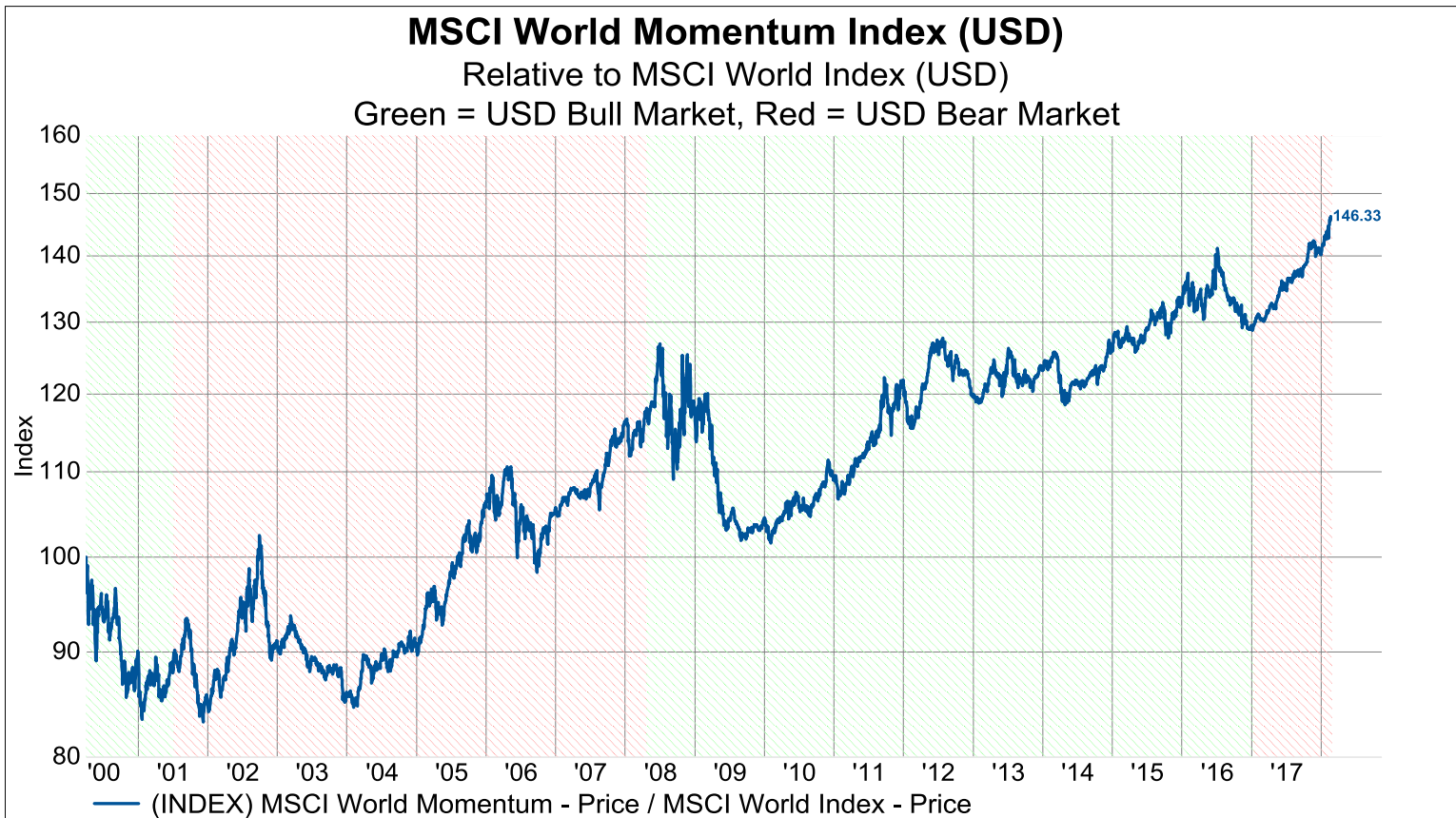


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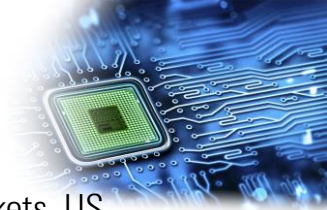


In general, stocks in the MSCI World Momentum Index outperform more in a USD bull market. The relative outperformance in early 2000s USD bear was about +30%, while the outperformance in the 2010s USD bull was about 12%.

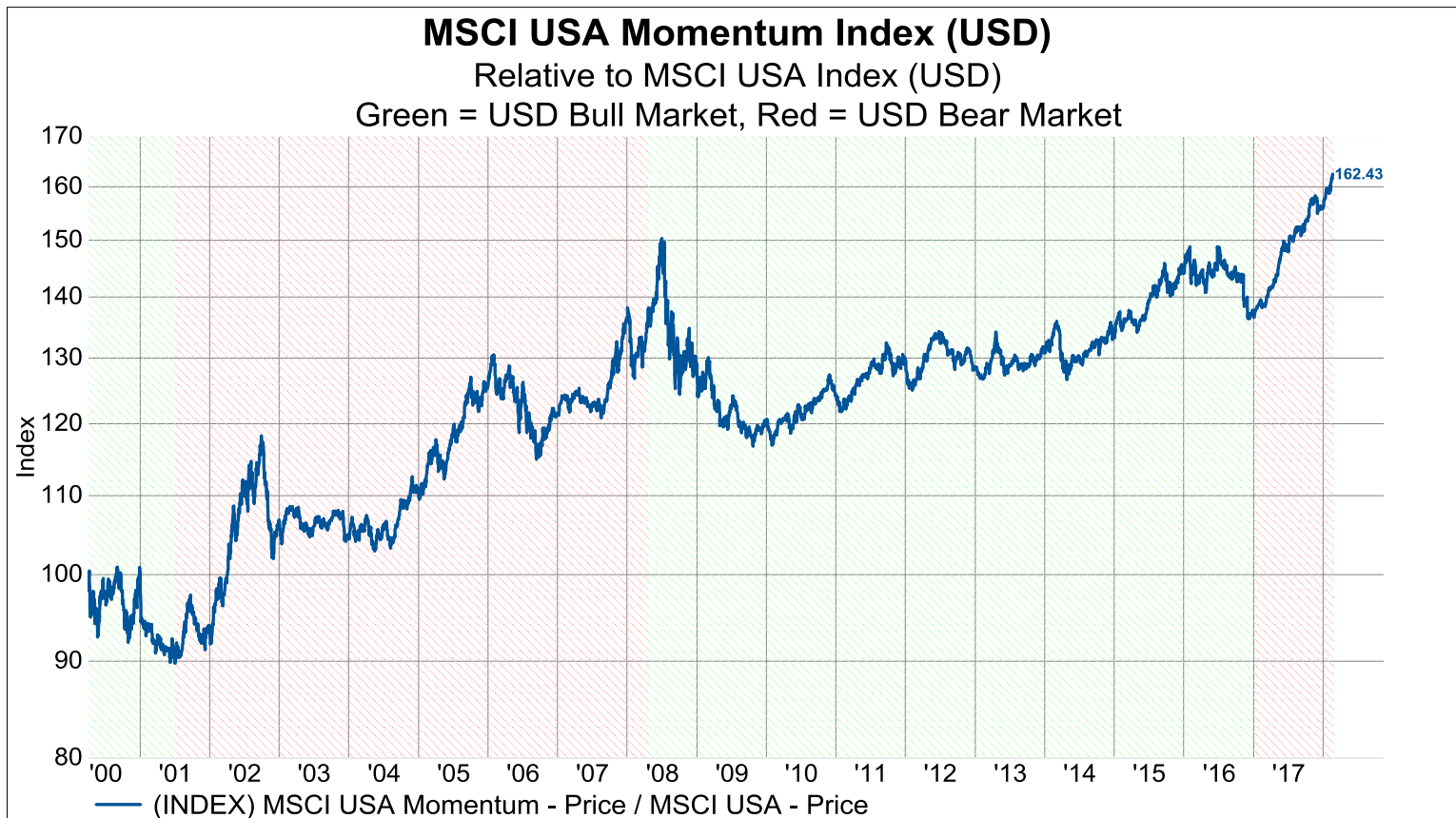


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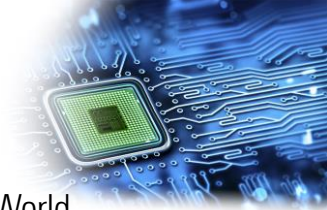


Stocks in the MSCI USA Momentum Index display a pronounced outperformance during USD bear markets. US momentum stocks outperformed by +45% during the 2000s USD bear market and only outperformed by about +2% in the 2000s USD bull market.

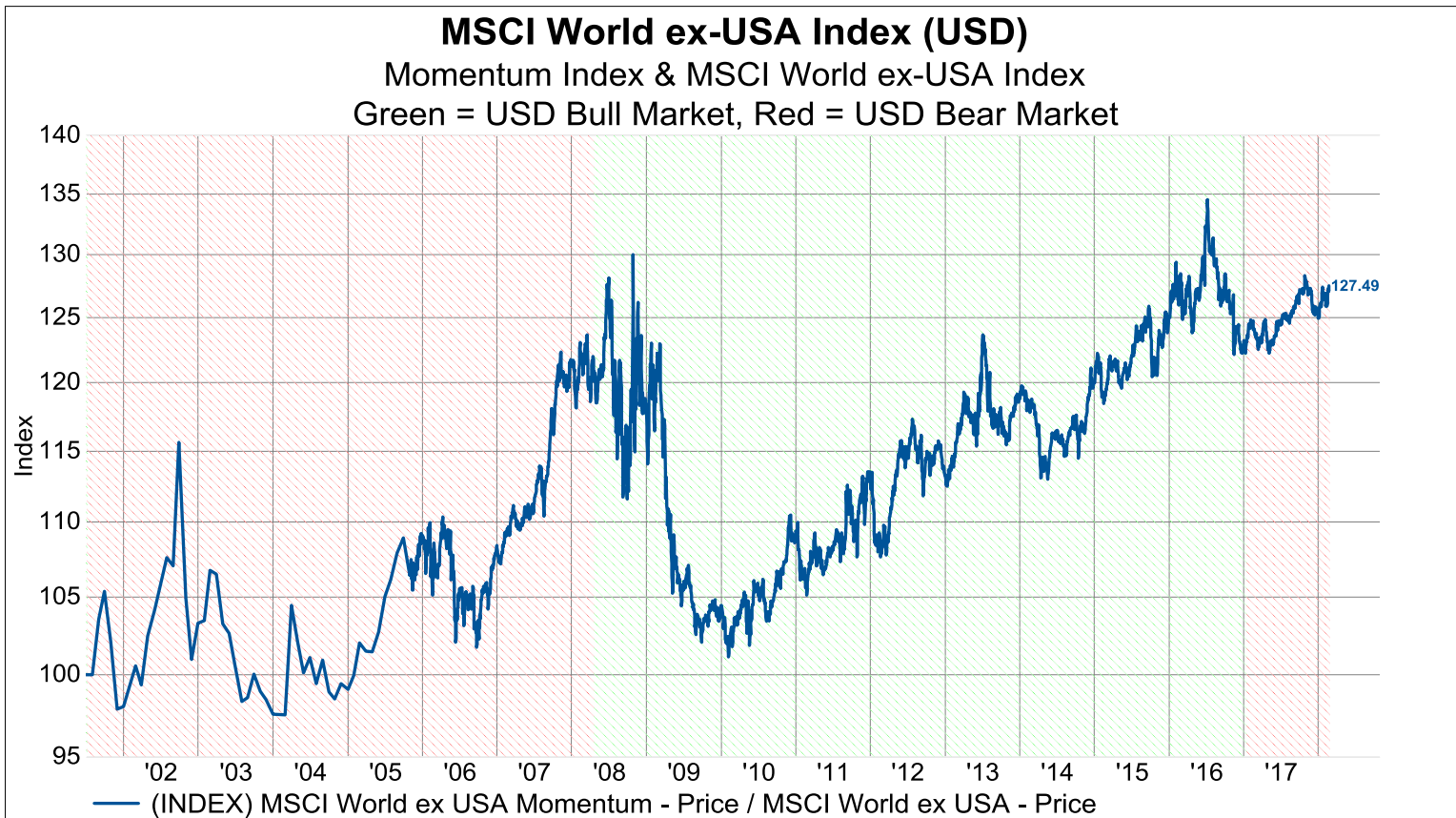


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Source: Factset

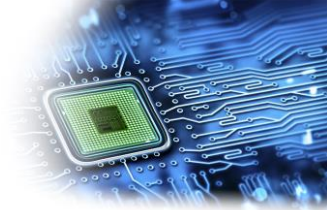


Foreign momentum stocks also outperformed by a greater extent during USD bear markets. The MSCI World ex-USA Momentum Index outperformed by 20% in the 2000s USD bear and only outperformed by about 2% during the 2010s USD bull market.

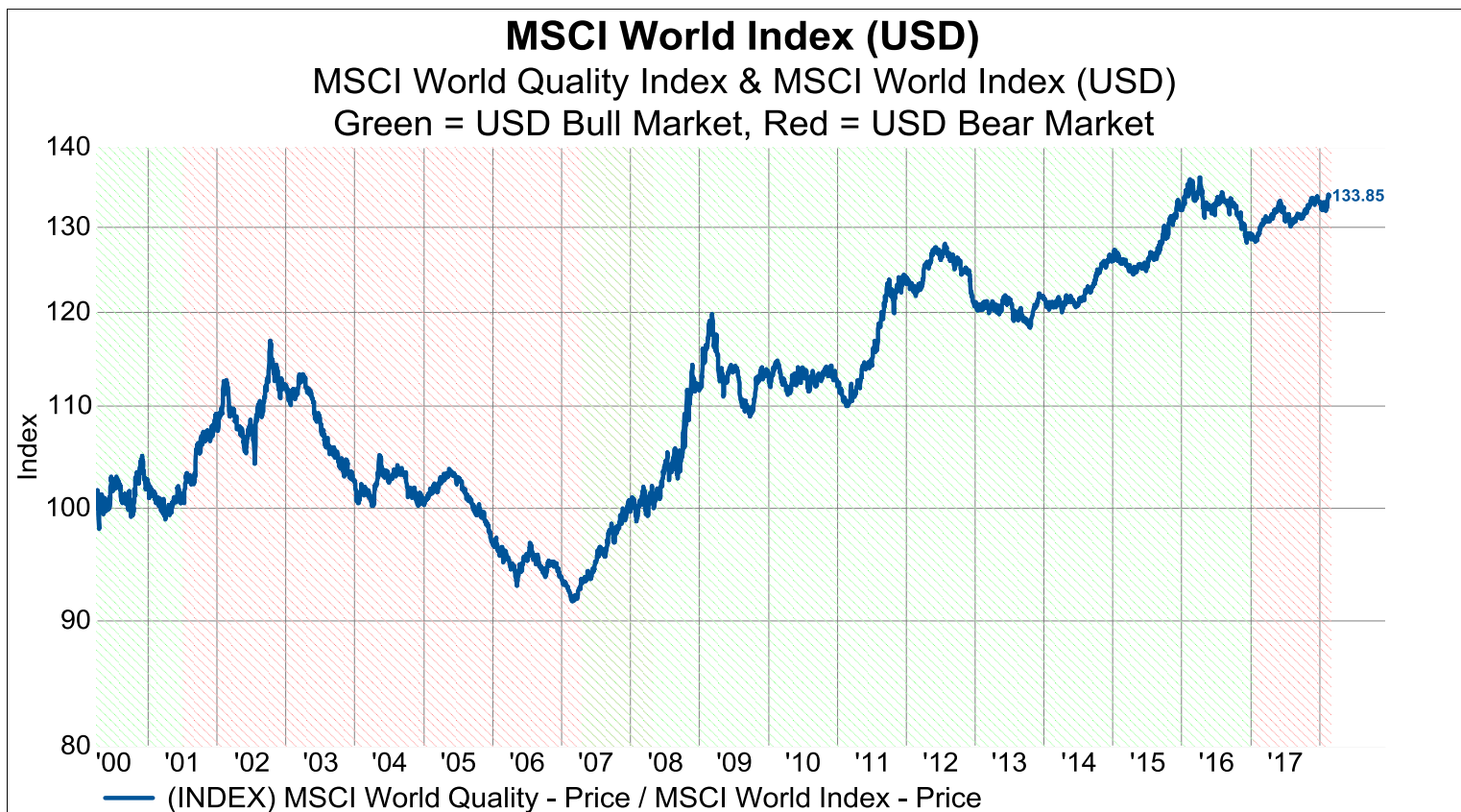


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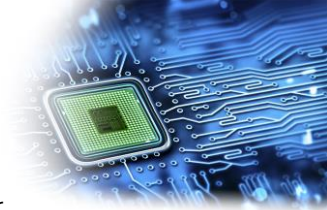


The MSCI World Quality Index tends to underperform during USD bear markets and outperforms during USD bull markets. Cumulative relative outperformance during USD bull markets is +35% while underperformance during USD bear markets is -5%.



Date: 3/31/2000 - Present

Source: Factset

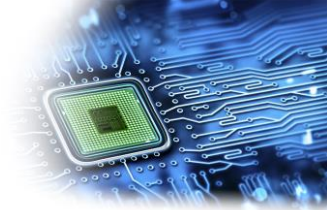


The MSCI USA Quality Index follows the same pattern as the world index, underperforming in USD bear markets and outperforming in USD bull markets. Cumulative outperformance during USD bull markets is about the same as MSCI World Quality Index, up +35%.



Date: 3/31/2000 - Present

Source: Factset

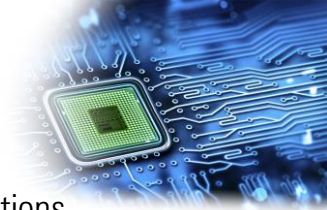


The MSCI World ex-USA Quality Index follows the same script as the world and US index in USD bull markets, but it performs better in USD bear markets. In the 2000s USD bear market, the MSCI World ex-USA Quality Index outperformed by about 7.5%.

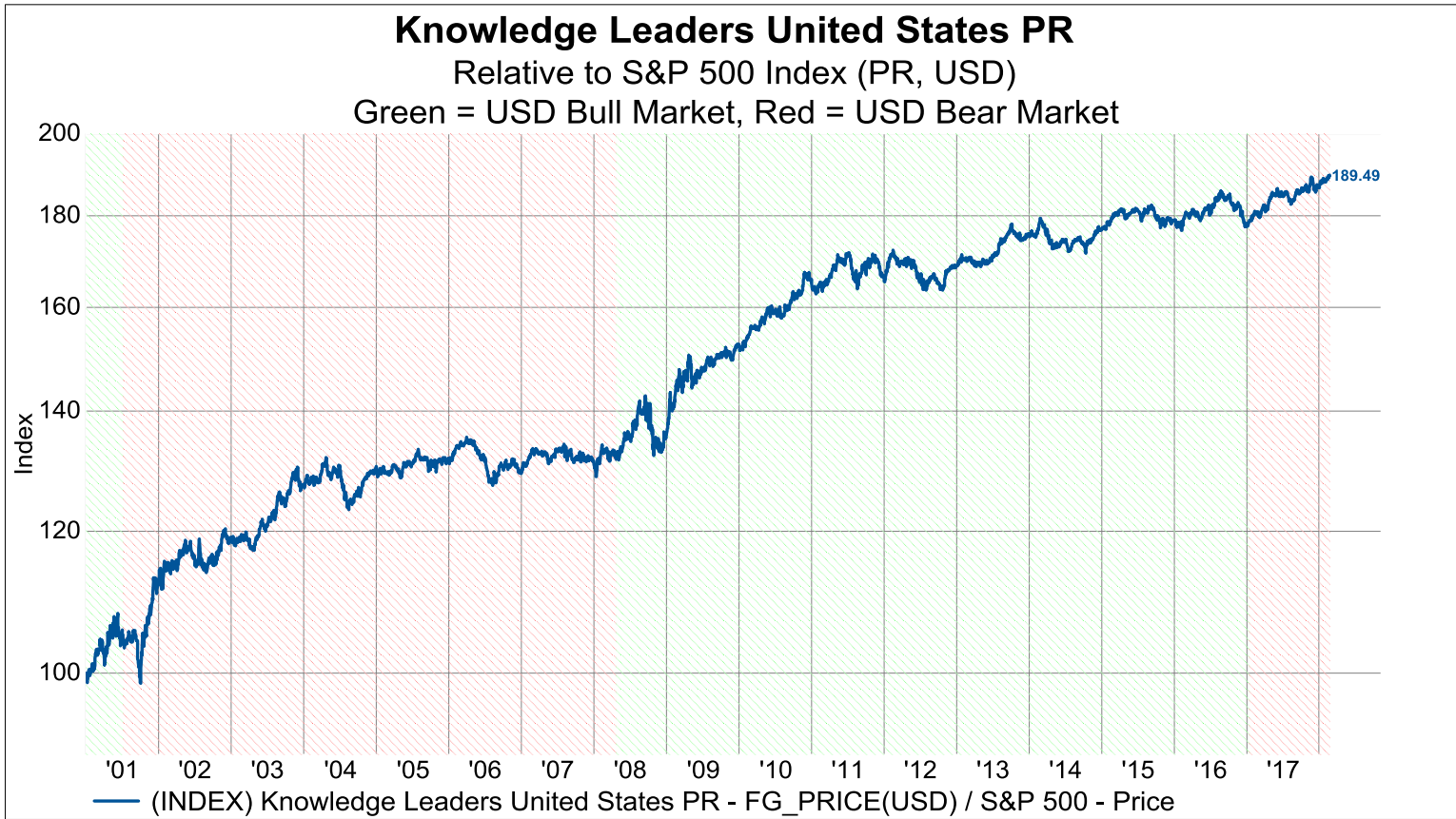


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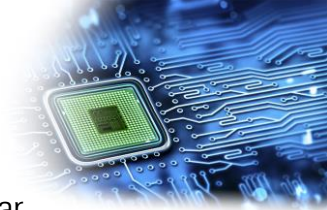
Source: Factset



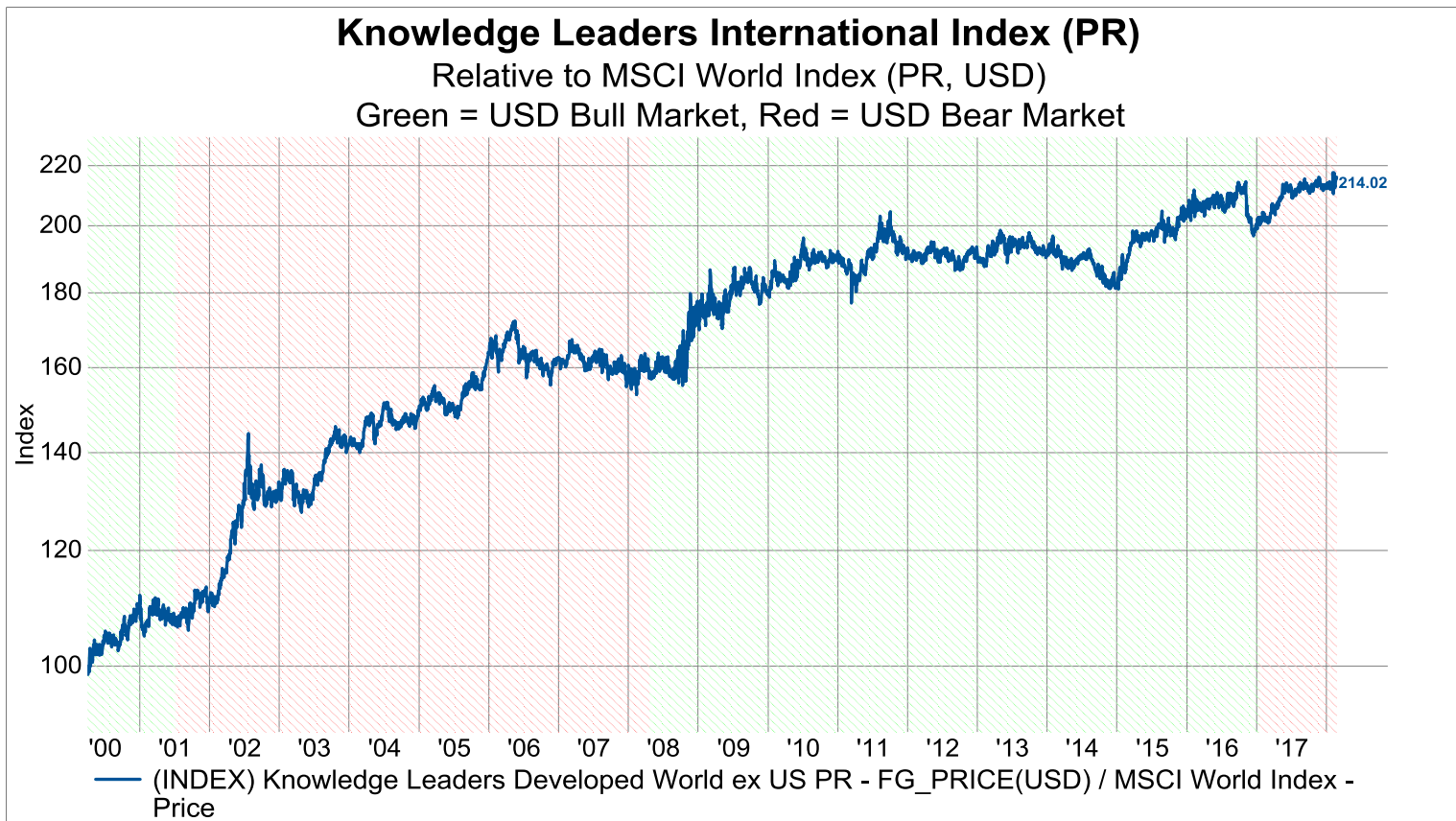
Our Knowledge Leaders United States Index does not experience the same relative performance oscillations around USD bull and bear markets. Part of this is due to our slight tilt toward smaller stocks.



Source: Factset. An investor cannot invest directly in an index.



In contrast, our Knowledge Leaders International Index tends to outperform slightly more during USD bear market phases. Cumulative relative performance during USD bear markets is +45% while outperformance during USD bull markets is +40%

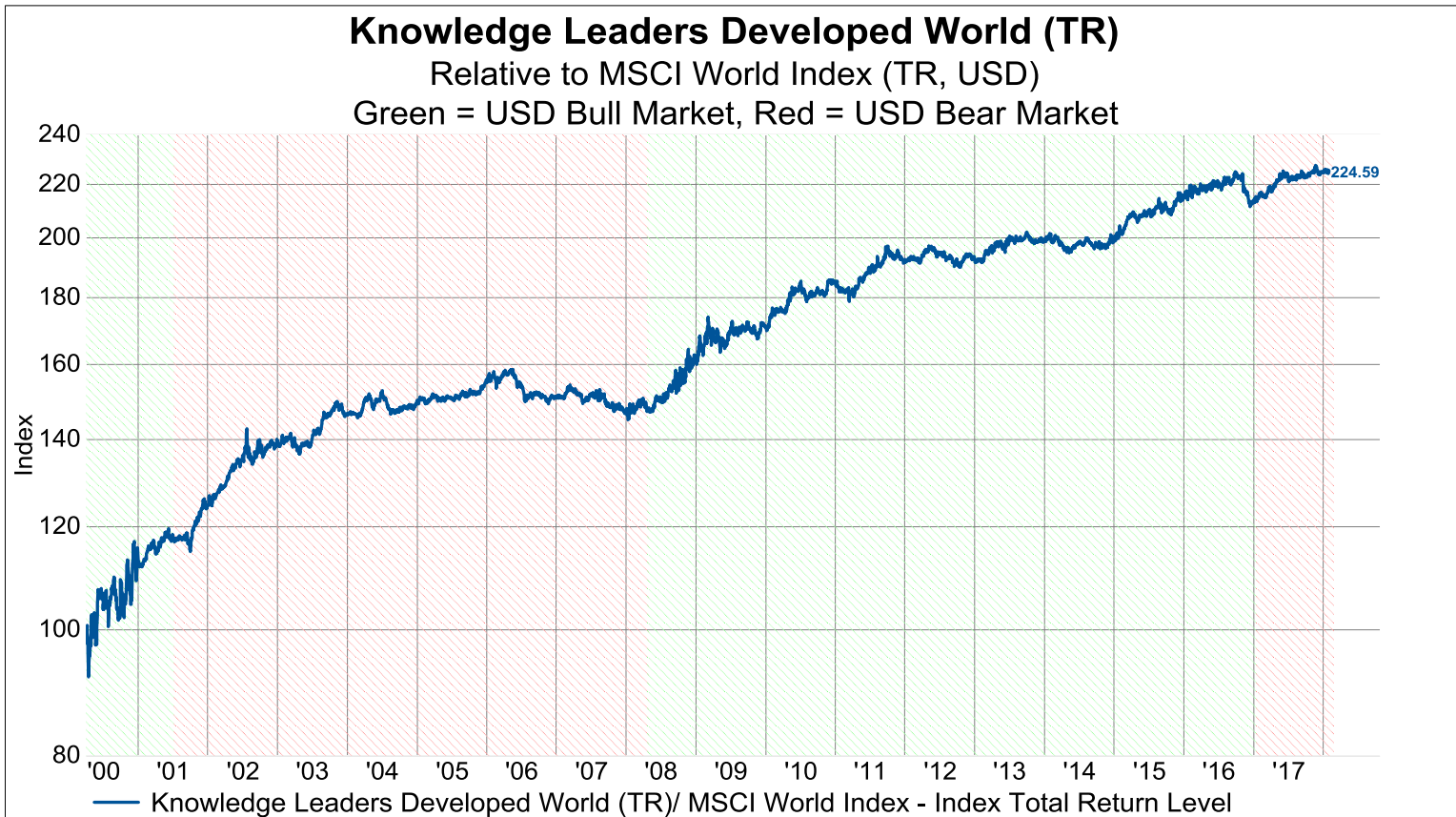


Date: 3/31/2000 - Present

Source: Factset. An investor cannot invest directly in an index.



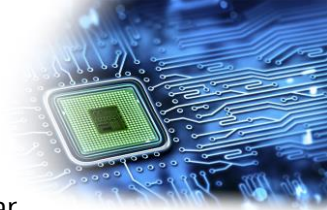
Our Knowledge Leaders Developed World Index—representative of the Knowledge Factor—outperforms in both USD bull and bear markets due to its large exposure to foreign companies and its tilt toward smaller companies.



Date: 3/31/2000 - Present

Source: Factset. An investor cannot invest directly in an index.





Putting this all together, we summarize the conclusions in the table below. If we have entered a USD bear market—and we believe we have—then the asset allocation framework called for is very different than the one that worked so well since 2008. While valuations globally have lifted a good bit since 2008, these groups below also represent the greatest areas of value in our work.

Factor	USD Bull Market	USD Bear Market
Geography	US	World ex-US
Cap Size	Larger	Smaller
Style	Growth	Value
Minimum Volatility	US	World ex-US
Momentum	US	World ex-US
Quality	US	World ex-US
Knowledge	US	World ex-US

**We would favor Knowledge Leaders due to their consistent relative outperformance.** We would also favor foreign companies over domestic, value over growth and smaller over larger.

Source: Factset



## Disclosures

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An investor cannot invest directly in an index.

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Past performance is not necessarily indicative of future results.

Beta is a measure of the funds sensitivity to market movements. A portfolio with a beta greater than 1 is more volatile than the market and a portfolio with a beta less than 1 is less volatile than the market.



Capture the Knowledge Effect in your portfolio

For investors interested in the Knowledge Leaders Strategy,  
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