Special Report on Market Volatility

> *"By prevailing over all obstacles and distractions, one may unfailingly arrive at his chosen goal or destination."*
>
> *Christopher Columbus*

February 10, 2018

Uneasy moments of uncertainty

The events of the last two weeks have been sobering. It is difficult, as an emotional human being, to witness the gains enjoyed during the past several weeks evaporate in a matter of a few days. News such as the implosion of the Credit Suisse Inverse Volatility ETN (XIV) only adds to the level of uncertainty. What will happen next? Is this the beginning of the end, or is it a buying opportunity? One thing is clear: we can expect market commentators to have a myriad of opinions on the subject matter as the market saga continues to evolve in the coming days and weeks.

There is no question the current bull market, which started in 2009, is becoming relatively old. At the same time, fundamentals are generally strong across the board, so there is a valid argument that the current bout of market volatility is merely a technical correction to purge off speculative excesses. It's easy, as humans, to fall prey to the latest analysis by the so-called experts: the bears argue the bull is old, valuations are high, inflation is picking up and thus the house of cards is about to collapse. Meanwhile the bulls argue fundamentals are strong and getting stronger, so there is lots of fuel for higher prices. But which ones are right? And more importantly, how can we methodically reach an intelligent decision?

Nothing is black and white!

At Laplace Insights™, we don't forecast using pundits' opinions, experts' analyses or human emotions. Instead, we believe in the **intelligence of data**. At the outset, this means to consider all markets and asset classes simultaneously, and examine their behaviors in terms of their prices, returns, volatilities and relative correlations. It also means to understand the current reality as it is, and reinterpret the data as the markets evolve. In particular, it implies accepting that no crystal balls and especially no simple 'right' answer truly exist. Importantly, it also means that no decision is black and white. This is unlike most experts' models which are usually created for convenience sake with an objective of greatly simplifying the very complex reality of financial markets.

Instead, we understand that there are probabilities of outcomes resulting from a very large set of possibilities. A good model, such as the one used by the Columbus™ strategy, uses a **statistically proven algorithm** that extracts intelligence from data to provide useful insights into this large set of possibilities. This type of computer algorithm has the ability to analyze and find the **most optimal balance** between all the available possibilities while adapting its view to market realities as more data becomes available.

Columbus has been there before

And we have good news! The current situation is nothing new to Columbus. It turns out that such "market surprises" happen on a regular basis, creating a volatility spike along with a good "slap in the face" for equity portfolios.

To put things in perspective, Columbus reached its peak on January 26, and subsequently lost 8.4% from that peak as of February 9 while the Year-to-Date loss is 2.1%. Similar or worse declines have occurred in 2004, 2006, 2010, and 2013, caused by events such as the 2004 interest rate fear, the 2006 inflation fear, the 2010 Greek debt crisis, and the 2013 China credit crunch.

Columbus is designed to stay away from major market losses that take years for a portfolio to recover from, such as the dotcom crash and the financial crisis. At the same time, it also captures most of the market upside when it is doing well. However, capturing such upside implies by definition that it must also experience the volatility that occurs during these periods. These bull market periods, and their periodic bouts of volatility are clearly seen in Figure 1 below, which illustrates the performance of Columbus over a 20 year period since February 1998. The downward pointing arrows show the four declines caused by the events mentioned earlier.

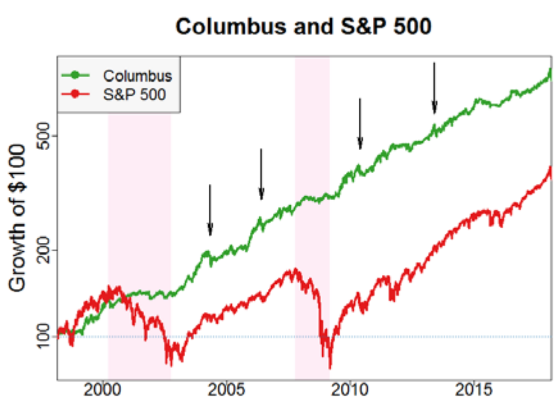

Figure 1

So what's next?

It may be tempting to rebalance the Columbus portfolio at this juncture, especially if one believes the bear story. However, previous history of market crises tells us otherwise as Figure 1 shows. There is nothing much different this time compared to these past crises, and in every case, Columbus ended up producing great returns afterwards.

It may be helpful to review a couple of typical historical situations to better internalize this important point. Figure 2(a) shows the Greek Crisis during the spring of 2010. In April and May, Columbus experienced volatility as markets started to tumble. However, it took a conservative stance when it rebalanced at the end of May (shown as the blue vertical line), as can be seen by the relatively flat Columbus curve during June while the S&P 500 continued its wild ride. This allowed Columbus to wait for the storm to pass and was a key move to protect capital in case things got from bad to truly ugly.

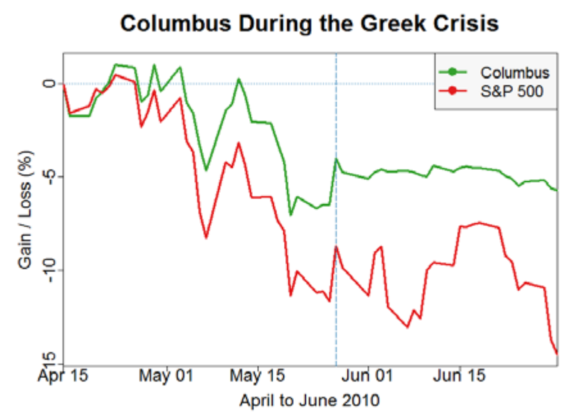

Figure 2(a)

Figure 2(b) shows the opposite situation, which occurred during the winter of 2007. Here, Columbus took a lot of sudden volatility, not unlike what we've experienced recently. However, this turned out to be a relatively minor correction, and Columbus stayed the course and eventually captured upside when markets recovered the following month.

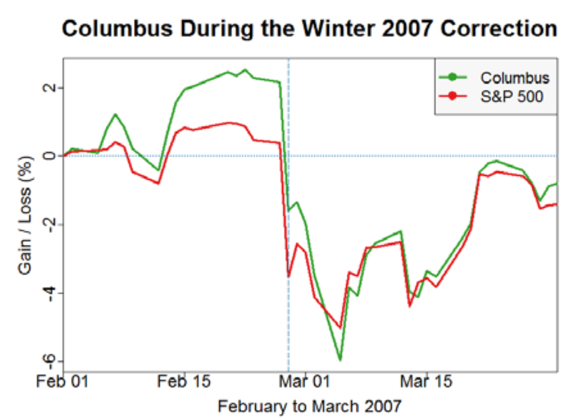

Figure 2(b)

If the current situation turns out to be the beginning of the end, rest assured that Columbus will absolutely adjust its portfolio to behave in a conservative way, similar to what it did during the Greek crisis.

Conversely, if the situation turns out to be a technical correction, Columbus will simply tweak its portfolio positions to allow to profit from the resuming bull market while managing risks based on the latest data.

This is the power of quantitative data combined with a statistically robust computerized algorithm. There is no second-guessing, no "expert" opinions and no emotions involved. There is only **data intelligence**.

Should you have any questions or concerns, please don't hesitate to contact me.

Sincerely,

Jean-Marc

About Laplace Insights

Laplace Insights™ was founded by Jean-Marc Patenaude out of his lifelong passion to find a better and safer way to invest. A machine learning data scientist and electrical engineer, Jean-Marc has a clear vision to deliver data and technology driven investment strategies to individual investors. Laplace Insights partners with financial advisors to effectively introduce investors to these strategies and to enable the benefits made possible by these advanced technologies.

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