NorthCoast Asset Management

Proper Benchmarking & the Cost of Playing Defense

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In the world of professional investment management, the first, last, and most-frequently asked question is some variation of "Did your strategy/fund/portfolio beat its benchmark?"

This document will break down the performance of CAN SLIM® against various benchmarks that also seek to obtain upside capital appreciation and downside risk management. This exercise will help understand the trade-offs being made over time, the value added by the strategy and also put the cost of downside protection into perspective. Before diving into the respective benchmarks, let's first determine the objectives of the CAN SLIM® Investment Program:

- Downside protection through cash scaling
  - Protection at the position level: Stop Losses
- Capital Appreciation
- Outperform the competitive benchmark (the S&P 500) over a full market cycle/long-term

CAN SLIM® is an interesting strategy in that, when looking at money management in a conventional framework, its two primary objectives (managing beta and generating alpha) are in direct conflict with each other. Generally speaking, an investment strategy either outperforms the market with the inevitable volatility/pullbacks/corrections (i.e. think 2000-2002 and 2008), or it aims to preserve capital by holding historically safer assets and strategies (cash reserves, fixed income, diversified asset allocation) at the expense of competitive returns on the upside (i.e. think 2003-2006, 2009-present).

What are appropriate benchmarks?

S&P 500: An index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe. (http://us.spindices.com/indices/equity/sp-500)

Competitors' Average: The equal average of three comparable investment programs/mutual funds: Good Harbor, F-squared, and Stadion.

HFRI Equity Hedge: The HFRI Monthly Indices ("HFRI") are a series of benchmarks designed to reflect hedge fund industry performance by constructing equally weighted composites of constituent funds. Equity Hedge Investment Managers maintain positions both long and short in primarily equity and equity derivative securities.

S&P 500 + Put Option: This Annual-Options methodology replicates the returns observed by an investor buying exposure in the S&P500 Index, and simultaneously buying an at-the-money one-year European Put option on the S&P500. This investor would pay the option premium upfront, invest the remainder of the capital in the S&P500, and receive dividends, price appreciation and the value of the option, if any, at expiration.

Morningstar Moderate: The Morningstar Target Risk Index family is designed to meet the benchmarking needs of target risk investors by offering an objective yardstick for performance comparison (http://www.morningstar.com/InvGlossary/morningstar-target-risk-indexes.aspx).

How competitive benchmarks stack up against those objectives
Performance Results: 1/1/2007 – 12/31/2014

Management Tactics	CAN SLIM® (Net)	S&P500	Competitors* Average	HFRI Equity Hedge Index	S&P500 + Put Option	Morningstar Moderate
Downside Protection	✓		✓	✓	✓	✓
Appreciation	✓	✓	✓	✓	✓	✓
Stop Loss	✓			✓		

Relevant Statistics	CAN SLIM® (Net)	S&P500	Competitors* Average (Net)	HFRI Equity Hedge Index	S&P500 + Put Option	Morningstar Moderate
R-Squared (to S&P 500)	57%	100%	33%	68%	48%	93%
Volatility	11%	16%	8%	7%	8%	10%
Drawdown	-21%	-51%	-12%	-21%	-23%	-32%

Annualized Performance	CAN SLIM® (Net)	S&P500	Competitors* Average (Net)	HFRI	S&P500 + Put Option	Morningstar Moderate
2007	12%	5%	7%	10%	2%	9%
2008	-13%	-37%	-6%	-19%	-9%	-22%
2009	9%	26%	3%	20%	10%	22%
2010	17%	14%	14%	10%	6%	12%
2011	-11%	1%	-7%	-5%	-6%	1%
2012	8%	15%	11%	6%	6%	12%
2013	27%	32%	18%	9%	20%	14%
2014	11%	13%	-7%	3%	9%	5%

CAN SLIM® Annualized Relative Performance to Competitive Benchmarks:
(+, Outperformance / –, Underperformance)

Relative Performance	S&P500	Competitors* Average	HFRI	S&P500 + Put Option	Morningstar Moderate
2007	+7%	+4%	+2%	+10%	+3%
2008	+24%	-8%	+6%	-5%	+9%
2009	-17%	+6%	-11%	-1%	-13%
2010	+3%	+3%	+7%	+12%	+5%
2011	-12%	-4%	-5%	-5%	-11%
2012	-7%	-3%	+2%	+2%	-4%
2013	-5%	+9%	+18%	+7%	+13%
2014	-2%	+18%	+8%	+2%	+6%
Long term average	**-1%**	**+3%**	**+3%**	**+3%**	**+1%**

CAN SLIM® outperformed all of these competitive benchmarks by average of 10% these last two years.

The CAN SLIM® investment methodology balances the desire for capital appreciation and downside protection. Comparing its performance to an index with different investment objectives, will lead to an inappropriate assessment of its performance. Another way to phrase this conundrum is to ask oneself, "If I could go back in time, without any knowledge of the future, which vehicle's investment objectives also suited my needs?"

Investing with a sophisticated methodology requires an understanding of the trade-offs in the investment mandate. By comparing the performance of the S&P500+ Put Option strategy with the S&P500 one gets a better understanding of how adding downside protection pays off and its performance impact. As can be seen below, the S&P500+Put Option strategy outperformed handsomely in 2008, but dragged in the other years. Over the period of 2007-2014, it lagged the S&P500 by an average of 4% per year, while lagging by an average of 9% during bull markets. These numbers reflect how the markets price the cost of downside protection. In other words, downside protection is not cheap. Because of its value, downside protection is in high demand as evidenced by the popularity of tail-risk funds.

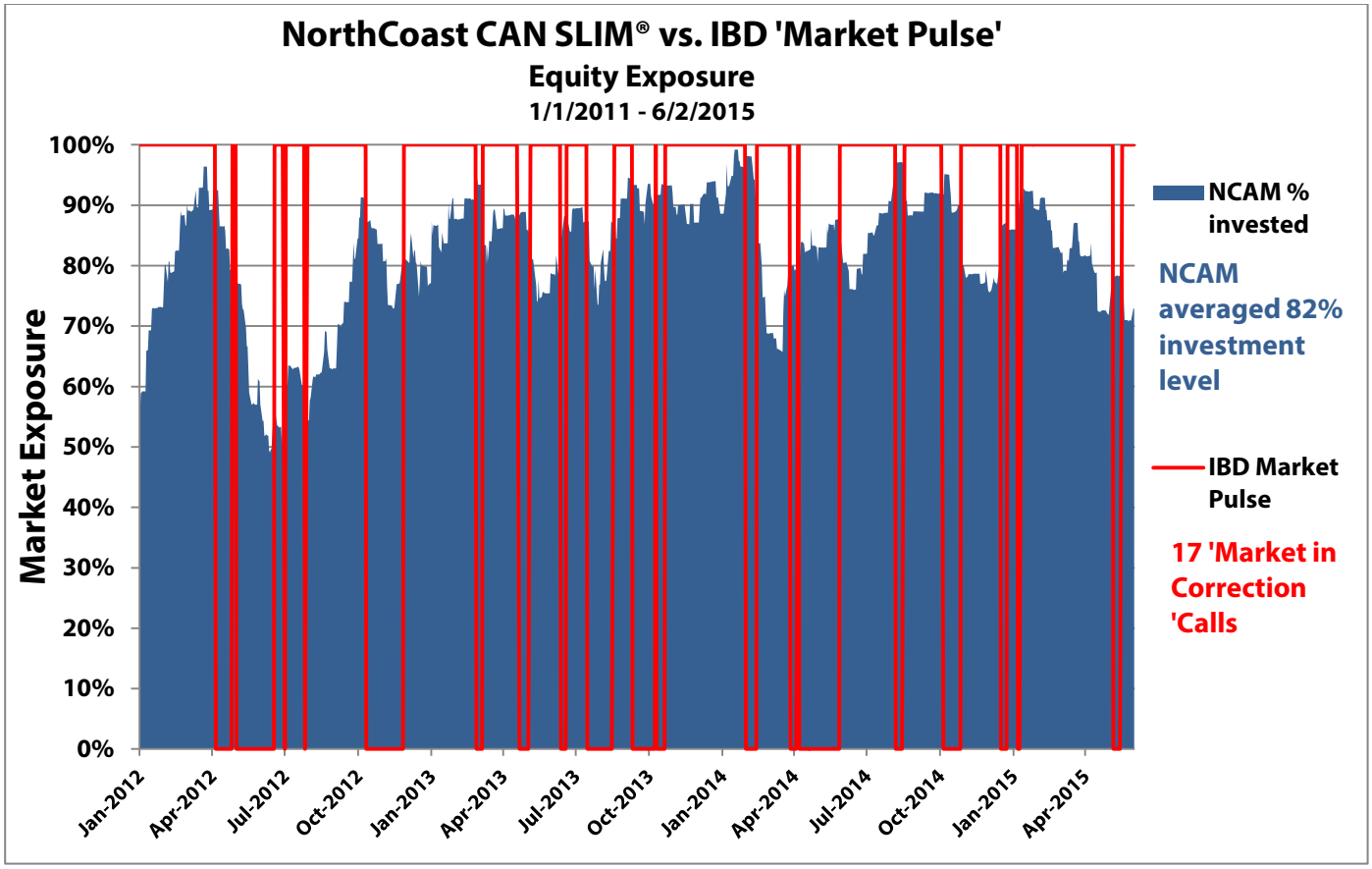
S&P500+ Put Option Relative Performance:

The chart displays the relative performance of the S&P500 + Put Option against the S&P 500	
2007	-3%
2008	+28%
2009	-16%
2010	-8%
2011	-7%
2012	-9%
2013	-12%
2014	-4%
Long term average	-4%
Average in a bull market	-9%

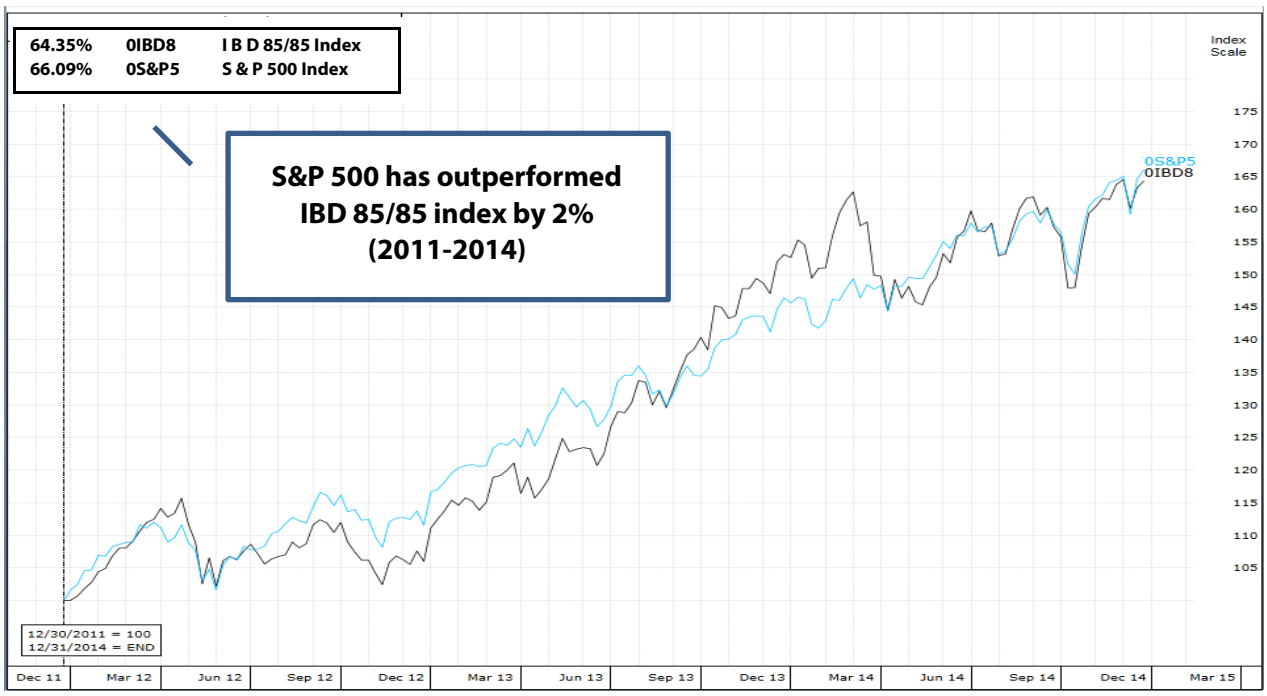
Downside protection has cost an annualized 4% over the past 8 years, and an annualized 9% over the past 6 years

Now let's take a look at CAN SLIM® by the Book:

'Market Timing', 'Cash Scaling', 'Beta Management': The risk management tactic has many names. But what is most important about the tactic is identifying specific risks within the equity market that warrant a change. CAN SLIM®, by the book, suggests a complete position in cash (no market exposure) when the market is in a 'correction'. The chart below highlights the periods in which a 'market in correction' was signaled utilizing IBD's buy and sell discipline ('Market Pulse'). The exposure moves from 100% equity to 0% exposure (displayed by the red line). In total, there have been 17 'Market in Correction' periods since January 2012. In other words, 17 times an investor went from 100% stocks to 100% cash in a three-year period. The blue line chart highlights the equity exposure in the NorthCoast CAN SLIM®. Over the same time frame, NorthCoast equity exposure ranged from 48% to 99%, with an average exposure of 82%.



The IBD 85/85 Index, a stock selection index that seeks to track the performance of stocks that meet two criteria; EPS and RS Ratings at 85 or better. Historically (over the last 50 years), stocks with these characteristics have had some of the largest gains among all common stocks, as stated in IBD's research. However recently, these metrics have not been predictive of superior stock performance as the general market (S&P 500) has outperformed this index over the last four(4) years.



When breaking down the two major objectives of the CAN SLIM® strategy, one can see that it effectively combines the tasks of managing risk while generating positive return through stock selection. While a strict buy-and-hold of the IBD 85/85 index has generated higher returns, it lacks defensive cash scaling in periods of correction and therefore does not factor in the cost of protection. When the IBD 'Market Pulse' is applied to this buy-and-hold strategy, performance expectedly suffers. When NorthCoast's cash-scaling model is applied to the IBD 85/85 index, it achieves a higher rate of return than the IBD 85/85 index with the IBD Market Pulse cash-scaling model. Even more, when NorthCoast's cash-scaling model was applied to its own enhanced CAN SLIM® stock selection methodology, greater performance was achieved.

	IBD 85/85 Buy & Hold Return (1)*	IBD 85/85 Index Return w/ IBD Market Pulse (2)*	CAN SLIM® Composite (Net)	IBD 85/85 w/ NorthCoast Cash Scaling model (1)*
2012	7.99%	13.66%	7.90%	5.69%
2013	42.27%	23.28%	26.90%	36.40%
2014	5.81%	-4.49%	10.90%	2.76%
$100,000 grows to:	**$162,563**	**$133,828**	**$151,849**	**$148,140**

CAN SLIM® portfolio has done a better job managing market exposure and done a better job picking stocks than IBD Index (no fee)

(1)* Performance does not include transaction costs or management fees
(2)* Performance displays IBD 85/85 Return incorporating a move/allocation to cash based on the IBD Market Pulse.

Past performance is not indicative of future results. All investments involve risk, including loss of principal.

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