GYROSTAT
RISK MANAGED EQUITY FUNDS

Portfolio structure and uncertainty

Regular income with downside protection always in place
Track record of returns increasing with volatility

"Doubt is not a pleasant condition, but certainty is an absurd one." Voltaire

"Our reasons are not prophets When oft our fancies are."

— William Shakespeare, The Two Noble Kinsmen

Executive summary: -

- The illusion of understanding. From the insights of Daniel Kahneman and Amos Tversky we see the world as more tidy, simple, predictable, and coherent than it really is. The illusion that one has understood the past feeds the further illusion that one can predict and control the future.
- Psychology – what retiree investors want.
- What are the 'experts' saying about the future?
- How to dealing with uncertainty. Base rates – they are ominous for market falls.
- Portfolio structure – diversified non correlated assets is key – address all the scenarios.
- Why Gyrostat?

The illusion of understanding

Nobel Laureate in Economics Daniel Kahneman draws together his lifetime of research in "Thinking, fast and slow". He challenges the rationale model of judgment and decision making and incorporates psychology to optimise structures to improve the outcomes for humans – to deliver what they really want.

Michael Lewis provides further insights into how this remarkable partnership between Daniel Kahneman and Amos Tversky helped shape the world in which we now live – and may well have changed, for good, humankind's view of its own mind. "The Undoing Project – A Friendship that Changed the World."

Their key findings on how the mind sees the world are:

- We see the world as more tidy, simple, predictable, and coherent than it really is. The illusion that one has understood the past feeds the further illusion that one can predict and control the future.[1] The mind arranged historical facts in ways that made past events feel a lot less uncertain, and a lot more predictable, than they actually were.[2]
- A prediction is a judgment that involves uncertainty.
- In such a highly unpredictable world Kahneman challenges the ability of 'experts' to assess the odds of highly uncertain events.

What do investors want?

Many investors, particularly retiree investors, want to preserve the lifestyle that they have. They want to take back control and maintain their self reliance in the face of a highly uncertain world.

Kahneman observed "When they made decisions, people did not seek to maximize utility. They sought to **minimize regret**."[3] What is 'risk aversion'? It amounted to a fee that people paid, willingly, to avoid regret:

[1] "Thinking Fast and Slow", Daniel Kahneman p.204
[2] "The Undoing Project: A friendship that Changed the World", Michael Lewis p.208
[3] "The Undoing Project: A friendship that Changed the World", Michael Lewis p.261

a regret premium. … the non-monetary consequences of decisions cannot be neglected, as they all too often are, in applications of utility theory."[4]

"There was just psychology. The understanding of any decision had to account not just for the financial consequences but for the **emotional** ones, too.

We'd further expand upon investor objectives. To be:

Self reliant in an unsettled, highly unpredictable world - to take back control

Adaptable - knowing market crashes are a regular and hazardous feature of stock markets. Protect and make money when this happens.

Resilient - understanding that predicting the future in an uncertain world can threaten your future when predictions are wrong

What are the experts saying about the future?

US Federal Reserve: Financial Stability Report May 2020

"Asset prices remain vulnerable to significant price declines should the pandemic take an unexpected course, the economic fallout prove more adverse, or financial system strains reemerge." (p8)

https://www.federalreserve.gov/publications/financial-stability-report.htm

George Soros: The crisis of a lifetime

Only one thing is certain about the post-pandemic world: there is no way back to the globalized economy that preceded it. Everything else is up for grabs, including the rise of China, the fate of the United States, and the survival of the European Union.

https://www.zerohedge.com/geopolitical/soros-has-faith-trump-will-destroy-himself-fears-weakened-xi-sees-existential-risk-eu

Stan Druckenmiller: Turns apocalyptic: Risk-Reward For Equities Is As Bad As I've Seen It In My Career"

"The wild card here is the Fed can always step up their purchases, that the government stimulus programs won't be enough to overcome the economic problems, that it makes no sense for the market to jump so much when optimism emerges around certain drugs like remdesivir ("I don't see why anybody would change their behavior because there's a viral drug out there") and, most concerning, that "there's a good chance that we just cracked the credit bubble that's the result of free money."

https://www.zerohedge.com/markets/druckenmiller-turns-apocalyptic-risk-reward-equities-bad-ive-seen-it-my-career

ABC: Australian investors, particularly retirees hurt from dividend payment cuts, risk of house price crash. Investors set to lose $10b in dividends as banks bunker down to weather coronavirus storm

Up to $10 billion in income could be ripped out of the economy in the space of months as the major banks suspend or slash dividend payments in response to a massive rise in bad loans and the risk of a house price crash. However, the banks' actions are in line with the recommendations of regulators.
They are urging banks around the world to suspend dividends and use the money to provision against bad loans as households dealing with rising joblessness and businesses hit by lockdown measures struggle to make payments.

https://www.abc.net.au/news/2020-05-14/investors-to-lose-10-billion-in-bank-dividends-from-coronavirus/12243836

[4] "The Undoing Project: A friendship that Changed the World", Michael Lewis p.261

Bank of America: divergence in opinions on market direction has never been greater

With the S&P trading nearly 800 points - or a whopping 30% - above its March 23 lows, the divergence in opinions whether this is a new bull market or merely a massive - and the fastest ever - bear market rally ever, propped up by trillions in central bank liquidity and fiscal stimulus, has never been greater.

"With the current fallout from the complete shutdown of economic life in terms of disruptions in supply chains and collapse of aggregate demand, as well as the uncertainty on the post-lockdown path to recovery, new market bottoms are possible, although the unprecedented massive policy response could provide the backstop to a worsening case of deflationary spiral."

https://www.zerohedge.com/markets/bear-market-rally-or-new-bull-bofa-has-answer-and-what-happens-next

South China Morning Post: Coronavirus: evidence of demand shock wave to China's economy piles up, as South Korean exports collapse.

South Korean exports plunged 46.3 per cent in the first 10 days of May, sparking fears that a second hit to China's economy is on the way

Cancelled ship sailings, plunging metals exports and diverging air and sea freight rates all paint an ominous picture for the future of China's economy

https://www.scmp.com/economy/china-economy/article/3083858/coronavirus-evidence-demand-shock-wave-chinas-economy-piles

How to deal with uncertainty? Base rate

In a world of such uncertainty, Kahneman and Tversky suggest that you start with a 'base' rate. Ie: What would you predict if you had no information at all.[5]

Judgments can then be imposed to vary from the base rate within bounds.

With stock markets, what are the base rates?

Research published by CMG Wealth, highlighting the findings of Bryce Coward, CFA, states:

<u>The base rate is that stock markets will re-test previous falls.</u>

"... in 19 of 19 post-war instances of a 15% uninterrupted decline (excluding the current one), the stock market ended up re-testing the waterfall low in some fashion. Basically, markets tend to rally after "waterfall" declines. Until recently, test case #20 (Q4 2018) was the outlier. That low has now been re-tested."

https://www.cmgwealth.com/ri/on-my-radar-pandemic-cycles-recession-begins/

Market	High 19 Feb 2020	50% decline level	Market 11 May	50% fall peak to trough scenario	March 23, 2020 lows	Re-test falls
SP500	3386	1693	2929	-42%	2237	-24%
Nasdaq	9817	4808	9121	-47%	6860	-24%
ASX200	7163	3581	5461	-34%	4546	-17%
Hang Seng	29056 *20 Jan	14528	24602	-41%	21696	-12%

<u>The base rate is that market corrections are a regular and hazardous feature of the investment cycle.</u>

[5] "The Undoing Project: A friendship that Changed the World", Michael Lewis p.199

Current market conditions and global uncertainty provide the opportunity to pro-actively address this risk through portfolio construction. This is particularly important for pre and post retirees exposed to sequencing risk.

In portfolio construction one of the scenarios to consider is the consequences to your portfolio if the market was to repeat the previous peak to trough falls. For instance, a 50% fall would see the SP500 at 1693, a reduction of 42.2% from current levels, as illustrated below.

SP500 index: 90 year historic chart. Peak to trough falls > 20, duration of falls, time to recover

Base rate: Major Corrections are a regular and hazardous feature of the market cycle.

The graph shows the extent of falls from peak to trough, the duration of the fall, and time taken to recover to pre fall. Most corrections occur within 8 years, now at year 13, longest on record is 13 years.

There are 8 instances of market corrections exceeding 40% within a 6-12 month timeframe.

Portfolio structure to help investors address uncertainty

An approach that has been well recognised to work for all market conditions is to construct a portfolio with diversified non-correlated assets.

Ray Dalio is the founder, co-Chief Investment Officer and co-Chairman of Bridgewater Associates, which is a global macro investment firm, the world's largest hedge fund.

His brief explanation on portfolio construction is available at:

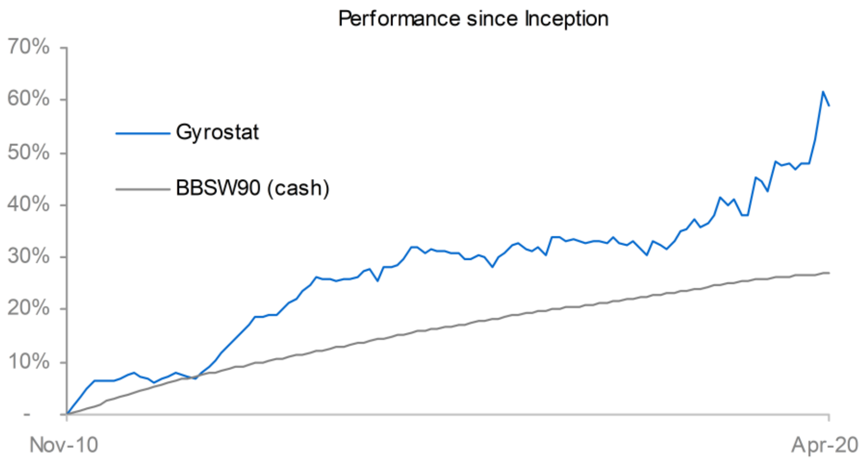
https://www.youtube.com/watch?v=Nu4lHaSh7D4&t=85s

If your portfolio suffered significant losses as at 31 March 2020 it is likely that your portfolio was not non-correlated between your 'defensive' and 'growth' assets. If you do not change the structure of your portfolio it is likely that similar losses will be experienced in future market corrections.

The rebound in stock markets now provides an opportunity to re-balance your portfolio to include defensive 'non correlated' assets which will benefit from any major market corrections.

Gyrostat can be **progressively added through the complete investment cycle** within established processes

- **Pre and post retirees**: At Statement of Advice review more conservative portfolio structure as move from growth to defensive assets with ageing
- **Growth portfolios**: Investors seek higher returns from their defensive assets
- **Self directed investor** currently has cash and seeks lower risk investments for income and returns



https://media.ausbiz.live/b19f43f1-fadf-433a-ab9e-0c6bc1a75b16

http://www.gyrostat.com.au/news/australian-financial-review-how-these-4-funds-beat-the-virus-crash/

http://www.gyrostat.com.au/news/feature-article-gyrostat-the-journey-to-compelling-value/

Why Gyrostat?

The unexpected happens.

Are you a:

- pre or post retiree wanting regular income.
- successful career or business executive who now prefers the *freedom* to focus on health, family and friends, passions, rather than fearing stock market falls.

Your life savings should give you the financial security to enable you to be:

Self reliant in an unsettled, highly unpredictable world - to take back control

Adaptable - knowing market crashes are a regular and hazardous feature of stock markets. Protect and make money when this happens.

Resilient - understanding that predicting the future in an uncertain world can threaten your future when predictions are wrong

Gyrostat is a defensive asset to fortify your portfolio in an uncertain world.