Caron's Corner Transcript – 3.17.2025

Volatility Brings The Return of Risk Control Strategies

- Markets have become volatile because the U.S. is changing its trade policies through tariffs.
- The U.S. goals are to level the trade playing field, increase local manufacturing and generate revenues to address the budget deficit.
- **This is likely to be a long-lasting trade policy**, expected to endure through future administrations.
- However, current implementation is creating volatility with an on-again/off-again approach, impeding corporate planning and reducing consumer confidence.
- With this said, **our job as an active manager is to understand what is actually happening, evaluate markets and opportunities, and then make investment decisions.**
- But it's important to understand one thing; we expect that volatility will be an ongoing market feature**, such that controlling for risk becomes critical.**
- So how do we control risk? Let's get into it!

Jim Caron: Hello, this is Jim Caron, CIO of the Portfolio Solutions Group. Welcome to another edition of Caron's Corner powered by The BEAT. As you know, The BEAT is our asset allocation framework with Bonds, Equities, Alternatives and Transitional short-term investments.

Today's topic is going to be about volatility, and the return of risk control strategies. Markets have become volatile because the U.S. is in the process of changing its trade policies with the rest of the world through tariff policies at a rapid pace. The goal from the U.S. perspective is to level the playing field in terms of trade, increase manufacturing and generate revenues to address the budget deficit. This is likely to be a long-lasting policy decision from the U.S., likely to endure through different and future presidential administrations. So markets might need to just get used to it. The implementation of these policies is creating volatility with the "on again, off again" approach that is being taken. This impedes corporations' planning efforts and reduces consumer confidence, as we are seeing in sentiment measures falling today. With this said, our job as investors is to understand what is happening, evaluate the market movements and potential opportunities, and then make investment decisions. But it's important to understand one thing. Market volatility will be a growing feature of the system, and controlling for risk is thus critical. How do we do that? Let's get into it!

"A global balance and risk control approach" is what we like to say. The ultimate goal of this approach is to manage a global balanced portfolio comprised of global equities, bonds, currencies and commodities, with the overriding goal of staying within a specified range of volatility of returns. Typically investors think of three gradations of risk (based on the VIX Volatility Index): 1) conservative, which is roughly approximately about a 4% volatility of returns, 2) moderate, which is about a 7% volatility of returns and 3) aggressive, which is about 10% or higher volatility of returns. We select a global balance portfolio as previously described and then create an efficient frontier and optimize the portfolio for risk-adjusted returns. As the market moves, which may also shift the efficient frontier, we rebalance the portfolio weights in an attempt to keep the portfolio placed with an optimized risk-adjusted return. Again, this is our goal to do this.

This is not a black box. Rather, it's a marriage between quantitative techniques to manage risk and returns and fundamental top-down macro analysis that helps us anticipate market movements with the goal of rebalancing portfolios in advance of market movements. This is where Sharp ratios and alpha are created. Volatility, we have to understand, is neither friend nor foe. It just is. In other words, volatility is just a feature of the markets. The question for investors is how they manage it. In our view, we think it's important to establish a process for managing volatility that we employ in our global balance and risk control strategies, or GBaR. It has proven to be a reliable method. The concept of managing volatility and optimizing risk-adjusted returns is not new. However, it has been as relevant to investors given that market returns come from passive and highly concentrated investments, mainly in large cap tech sectors. But this is changing, as is fiscal policy, including tariffs. This may lead to higher volatility, which places a higher relevance to investors on risk-adjusted returns today and going forward and therefore risk controlled active management approaches to mitigate volatility across. Portfolios becomes again much more relevant at this time.

As we have mentioned numerous times in the past, the correlation of returns between bonds and equities are very high and likely to stay high, which means that bonds are a less effective hedge to equities for passive investments. Actively balancing the allocation weights between equities and bonds is a potential solution in a process we employ in our investment strategies. As we like to say, times are changing. What are you doing to change with them?

RISK CONSIDERATIONS

Diversification does not eliminate the risk of loss. There is no assurance that the Strategy will achieve its investment objective. Portfolios are subject to market risk, which is the possibility that the market values of securities owned by the portfolio will decline and that the value of portfolio shares may therefore be less than what you paid for them. Market values can change daily due to economic and other events (e.g. natural disasters, health crises, terrorism, conflicts and social unrest) that affect markets, countries, companies or governments. It is difficult to predict the timing, duration, and potential adverse effects (e.g. portfolio liquidity) of events. Accordingly, you can lose money investing in this portfolio. Please be aware that this strategy may be subject to certain additional risks. The success or failure of such decisions will affect performance**. Active Management:** in pursuing the Portfolio's investment objective, the Adviser has considerable leeway in deciding which investments to buy, hold or sell on a day-to-day basis, and which trading strategies to use. There is the risk that the Adviser's **asset allocation methodology and assumptions** regarding the Underlying Portfolios may be incorrect in light of actual market conditions and the Portfolio may not achieve its investment objective. Share prices also tend to be volatile and there is a significant possibility of loss. The portfolio's investments in **commodity-linked notes** involve substantial risks, including risk of loss of a significant portion of their principal value. In addition to commodity risk, they may be subject to additional special risks, such as risk of loss of interest and principal, lack of secondary market and risk of greater volatility, that do not affect traditional equity and debt securities. **Currency fluctuations** could erase investment gains or add to investment losses. **Fixed-income securities** are subject to the ability of an issuer to make timely principal and interest payments (credit risk), changes in interest rates (interest-rate risk), the creditworthiness of the issuer and general market liquidity (market risk). In a rising interest-rate environment, bond prices may fall and may result in periods of volatility and increased portfolio redemptions. In a declining interest-rate environment, the portfolio may generate less income. **Longer-term securities** may be more sensitive to interest rate changes. **Equity and foreign securities** are generally more volatile than fixed income securities and are subject to currency, political, economic and market risks. Equity values fluctuate in response to activities specific to a company. Stocks of **small-capitalization companies** carry special risks, such as limited product lines, markets and financial resources, and greater market volatility than securities of larger, more established companies. The risks of investing in **emerging market** countries are greater than risks associated with investments in foreign developed markets. **Exchange traded funds (ETFs)** shares have many of the same risks as direct investments in common stocks or bonds and their market value will fluctuate as the value of the underlying index does. By investing in exchange traded funds ETFs and other **Investment Funds**, the portfolio absorbs both its own expenses and those of the ETFs and Investment Funds it invests in. Supply and demand for ETFs and Investment Funds may not be correlated to that of the underlying securities. **Derivative instruments** can be illiquid, may disproportionately increase losses and may have a potentially large negative impact on the portfolio’s performance. A **currency forward** is a hedging tool that does not involve any upfront payment. The use of **leverage** may increase volatility in the Portfolio.

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Past performance is no guarantee of future results. The returns referred to in the audio are those of representative indices and are not meant to depict the performance of a specific investment.

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RO 4297672 Exp. 3/31/2026