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INVESTMENT MANAGEMENT

Alpha Bonds Strategy



# Alpha Bonds Strategy

## Strategy Overview

The Alpha Bonds Strategy combines conservative bond funds with Alpha's fourth quarter "power periods" to create what we believe is a unique solution to the conservative investor's dilemma: how to safely invest for income while increasing the asset base at a rate greater than inflation after taxes.

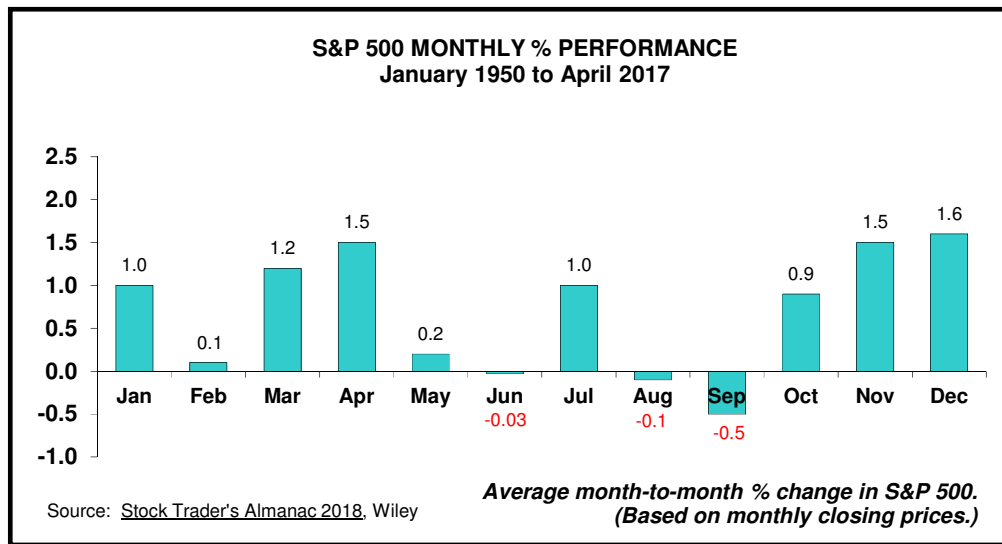
This strategy is designed for investors who seek income, low volatility and an ongoing exposure to the bond market without attempting to time swings in interest rates, and without some of the price and credit risks associated with long-term and/or lower grade bonds. Given the current low interest rate environment, the long-term return target for this strategy is 6% - 7% annually over rolling five-year periods.

The strategy uses a combination of short-term and intermediate-term bond funds. Each year, the strategy assumes a "normal allocation" of 70% intermediate-term bond funds / 30% short-term bond funds from January until late-October. At that point, we take 60% of the portfolio and dedicate it to three "power period" trades leveraged by 50% which exploit the unique profit opportunities of the fourth quarter of the year. For more detailed information of how the strategy is allocated on an annual basis, please refer to the Annual Asset Allocation description included in this brochure.

## The Fourth Quarter and Small Cap Stocks

According to our research, the fourth quarter of the year is the best quarter for the stock market. In particular, the period from late-October to year-end has been historically consistent in producing above-average gains.

As you can see from the table below, the May to October period has been historically weak compared to the rest of the year.



In fact, the stock market (as represented by the S&P 500 Index above) during this period has historically been flat on average, with September's dismal performance making it the worst performing month of the year. This summer weakness is not just a U.S. phenomenon. Academic research has established this pattern of weak-to-negative returns in the summer for 36 out of 37 developed and emerging markets. In many of these markets, the summer "dead zone" is far more pronounced than in the U.S.

There is much speculation about what causes this pattern, but no consensus. One likely cause is the tendency of stock market pundits and research firms to revise their yearly forecasts downward as the fourth quarter approaches. Their forecasts are almost always too optimistic. In addition, institutional investors do quite a lot of tax rebalancing just prior to the fourth quarter, which puts downward pressure on the market. Whatever the cause, the effect is undeniable – the market tends to deliver sub-par returns from May to October, then "wakes up" in November. The average daily gain for the Dow Industrials from November to May was 27.4 times higher than the average daily gain during all other trading days (1949-2007).

This resurgence in the stock market is particularly strong in small cap stocks. It appears that investors looking at rosier forecasts for the new year tend to concentrate on stocks that are perceived to have more profit potential. Market observers have long noted that small cap stocks outperform large cap stocks at year-end. The average return for the Russell 2000 small cap index in December since its inception in 1979 has been 2.7%, compared to the S&P 500's average of 1.7% (1979-2017).

## Power Periods

In the fourth quarter there are three sub-periods (we call them “power periods”) which have historically been especially potent and consistently positive. They are:

**Power Period #1:** Last two trading days of October, first two trading days of November

**Power Period #2:** Last six trading days of November, first three trading days of December

**Power Period #3:** Last seven trading days of December

These three periods exploit other lesser known “seasonal factors” in addition to small cap dominance at year end. For example, our research has found that the stock market performs better during the month-end and month-beginning period than other times. Also, the market tends to produce above-average returns around holiday periods (Thanksgiving and Christmas).

The table to the right shows the performance of the Russell 2000 small cap index since its inception during our three “power periods” outlined above.

Employing this strategy, there have been just four losing quarters over this time period, representing an 89.7% win rate.

The Alpha Bonds Strategy uses special leveraged small-cap index funds to increase the “beta” of these power period trades to 1.5. We believe that this is a controlled risk, justified by the historical track record of the Russell 2000 index to produce positive returns during these periods.

The **1.5 Beta Statistics** section of the chart shows that there have been four historical losses, while the average trade has generated gains of 2.8%. Overall, the three power periods have produced an average gain of 8.5% per quarter while exposing assets to market risk just 8% of the time each year.

While historical performance may not be indicative of future performance, with an 89.7% win rate this particular trend remains one of the most consistent market-based factors we are aware of.

<b>Russell 2000 Fourth Quarter Power Periods</b>						
Year	Power Period One	Power Period Two	Power Period Three	Total Return	Total Return With 1.5 Beta	
1979	2.37%	6.05%	1.85%	10.8%	16.6%	
1980	1.33%	0.12%	2.16%	3.6%	5.4%	
1981	3.11%	2.18%	0.12%	5.5%	8.4%	
1982	2.72%	2.64%	2.30%	7.9%	12.0%	
1983	-0.91%	0.73%	1.36%	1.2%	1.8%	
1984	0.53%	-2.26%	0.79%	-1.0%	-1.5%	
1985	1.02%	3.27%	1.58%	6.0%	9.2%	
1986	1.18%	3.00%	-1.38%	2.8%	4.2%	
1987	10.80%	-5.20%	0.49%	5.8%	8.4%	
1988	0.21%	2.48%	1.98%	4.8%	7.2%	
1989	0.17%	1.08%	3.33%	4.7%	7.1%	
1990	0.55%	5.26%	1.24%	7.3%	11.0%	
1991	1.08%	-0.17%	7.56%	8.8%	13.4%	
1992	0.92%	2.89%	2.79%	6.8%	10.3%	
1993	1.64%	1.16%	3.19%	6.1%	9.3%	
1994	0.60%	-1.55%	3.99%	3.0%	4.6%	
1995	2.17%	3.92%	3.22%	9.7%	14.9%	
1996	0.55%	3.01%	1.82%	5.5%	8.4%	
1997	1.73%	0.75%	3.99%	6.6%	10.0%	
1998	4.27%	0.18%	4.93%	9.7%	14.9%	
1999	3.70%	0.75%	5.95%	10.9%	16.6%	
2000	5.58%	1.20%	5.48%	12.4%	18.7%	
2001	0.88%	5.93%	1.37%	8.3%	12.6%	
2002	4.91%	2.39%	-0.06%	7.3%	11.0%	
2003	1.34%	3.72%	1.85%	7.0%	10.6%	
2004	-0.29%	4.61%	0.84%	5.2%	8.0%	
2005	5.21%	1.15%	0.09%	6.5%	9.9%	
2006	-2.05%	0.72%	0.73%	-0.7%	-1.1%	
2007	-2.86%	3.52%	1.39%	1.7%	2.3%	
2008	10.86%	11.34%	2.87%	25.7%	38.6%	
2009	0.84%	0.60%	1.11%	2.4%	3.5%	
2010	1.25%	4.40%	-0.87%	4.8%	7.2%	
2011	-4.22%	6.43%	0.36%	2.3%	3.5%	
2012	0.14%	2.78%	0.17%	3.1%	4.7%	
2013	-1.14%	1.96%	3.39%	4.2%	6.3%	
2014	1.66%	1.84%	0.73%	4.3%	6.5%	
2015	1.09%	0.33%	0.72%	2.2%	3.3%	
2016	-2.31%	1.18%	-1.94%	-3.1%	-4.6%	
2017	-0.78%	-0.14%	-0.08%	-1.0%	-1.5%	

<b>1.5 BETA STATISTICS</b>	
<b>Total Quarters = 39</b>	<b>Average Quarter Return = 8.5%</b>
<b>Losing Quarters = 4</b>	<b>Market Exposure = 8%</b>
<b>Win Rate = 89.7%</b>	<b>Average Gain Per Trade = 2.8%</b>
<b>Largest Quarter Loss (2016) = -4.6%</b>	
<b>Largest Quarter Gain (2008) = 38.6%</b>	

**Disclosures:** Past performance is not a guarantee of future performance. **The data presented above does not represent actual trading and is not representative of the returns of the Alpha Bonds Strategy.** This data is provided for illustrative purposes only. For the actual returns of the strategy, please refer to the Alpha Bonds Strategy Performance History included in this brochure. The Russell 2000 is a small-cap stock market index of the bottom 2,000 stocks in the Russell 3000 Index and is the most common benchmark for mutual funds that identify themselves as “small-cap”. As of December 31 2017, the weighted average market capitalization for a company in the index is around \$2.4 billion. Indexes are not investment vehicles and persons cannot invest directly in an index. The returns are based on price data only and do not include dividends and should not be considered return or performance data. Index funds may vary somewhat from index returns due to management fees and portfolio structure. The illustration is designed to quantify the effect of certain time periods on the Russell 2000 Index. Data Source: <http://www.marketwatch.com/investing/index/RUT/historical>

# Alpha Bonds Strategy

## Annual Asset Allocation

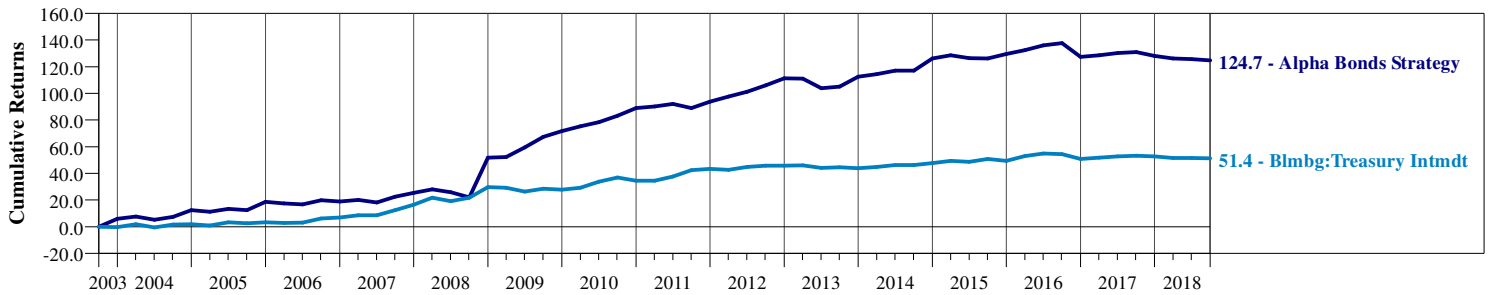
Below is the annual asset allocation chart for the Alpha Bonds Strategy. As you can see, the strategy is allocated to 70% intermediate-term bond funds / 30% short-term bond funds from January 1 until late-October of each year. Then in late-October, 40% of the portfolio remains in intermediate-term bond funds while 60% of the portfolio is devoted to our three "power period" trades using the Russell 2000 Index leveraged by 50%. While not invested in the three fourth quarter trades, 60% of the funds are allocated to cash/money market.

<b>ALPHA BONDS STRATEGY</b>	
<b>ANNUAL ASSET ALLOCATION</b>	
<b>January 1</b> → <b>Late-October</b>	<b>70% Intermediate-Term Bond Funds 30% Short-Term Bond Funds</b>
<b>Late-October</b> → <b>December 31</b>	<b>40% Intermediate-Term Bond Funds</b>
	<b>PLUS</b>
<b>Power Period Trade #1</b> Last Two Trading Days of October First Two Trading Days of November	<b>*60% Russell 2000 Small Cap Index x 1.5 beta</b>
<b>Power Period Trade #2</b> Last Six Trading Days of November First Three Trading Days of December	<b>*60% Russell 2000 Small Cap Index x 1.5 beta</b>
<b>Power Period Trade #3</b> Last Seven Trading Days of December	<b>*60% Russell 2000 Small Cap Index x 1.5 beta</b>
<b>*Note: The days between power periods will be allocated to cash/money market.</b>	
<b>Conventional Growth and Income Portfolio (40% Stock / 60% Bond) Market Risk = 40%</b>	
<b>Alpha Bonds Strategy Market Risk = 8%</b>	
<b>Alpha Risk Reduction = 75%</b>	

We believe that the conservative mix of bonds combined with the controlled risk exposure to equities in the fourth quarter of each year offers an attractive opportunity for investors who seek capital growth with strong risk management.

# Alpha Bonds Strategy Performance History *Net of Fees and Expenses*

## Cumulative Returns for 15 Years Ended September 30, 2018



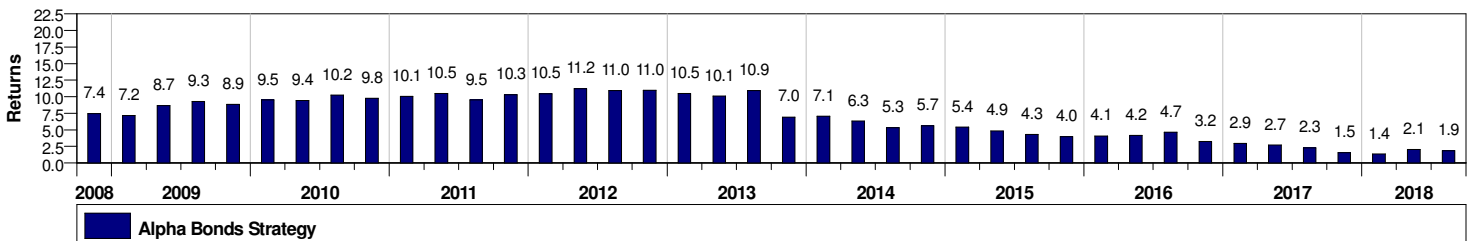
## Annual Returns for Calendar Years 15 3/4 Years Ended September 30, 2018

	3 Qtrs. 2018	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003
Alpha Bonds Strategy	-1.49	0.34	-0.97	1.48	6.52	0.54	8.93	2.58	10.03	13.23	20.99	5.48	0.18	5.56	6.00	8.39
Blmbg:Treasury Intmtd	-0.81	1.14	1.06	1.18	2.57	-1.34	1.71	6.57	5.29	-1.41	11.35	8.83	3.51	1.56	2.02	2.11

## Compound Annual Returns for Periods Ended September 30, 2018

	Last Quarter	1 Year	Last 2 Years	Last 3 Years	Last 4 Years	Last 5 Years	Last 6 Years	Last 7 Years	Last 8 Years	Last 9 Years	Last 10 Years	Last 11 Years	Last 12 Years	Last 13 Years	Last 14 Years	Last 15 Years
Alpha Bonds Strategy	-0.40	-2.74	-2.74	-0.23	0.88	1.86	1.46	2.50	2.59	3.32	6.30	5.67	5.37	5.47	5.42	5.54
Blmbg:Treasury Intmtd	-0.12	-1.22	-0.98	0.17	0.88	0.93	0.63	0.88	1.26	1.83	2.20	2.74	3.00	3.03	2.88	2.80

## Rolling 20 Quarter Returns for 10 Years Ended September 30, 2018



**Disclosures:** Past performance is not a guarantee of future performance. Returns presented above include both actual client performance and hypothetical (backtested) performance.

**Actual client performance:** Beginning October 2009, actual client net composite returns are used. The net client composite returns include all internal accounts managed by Alpha Investment Management at various custodians that pay Alpha advisory fees ranging from 0.8% to 2.0% annually, and as such, individual results may vary. The Alpha client composite returns are calculated using the time-weighted rate of return method. The monthly composite level performance is calculated by asset-weighting portfolio performance, using end of month market values. Trade date accounting is used for calculation and valuation purposes. The composite returns are net of all fees and trading expenses and reflect reinvestment of dividends, interest and capital gains. Performance results do not reflect the impact of taxes.

A model portfolio of the same name as this strategy may be managed by Alpha and offered by investment advisors at various trading/investment platforms, TAMPs, and/or custodians outside the parameters of the internal Alpha client composite returns. Assets invested in such model portfolios may experience significant dispersion in returns from those of the internal Alpha client composite. The causes of dispersion may include, but are not limited to, higher or lower advisory fees, custodial fees, trading expenses, the date on which a client engaged Alpha's investment management services, and the preference/availability of funds used to implement the strategy (i.e. ETFs vs. mutual funds) at the custodial level.

**Hypothetical (backtested) performance:** Returns presented prior to October 2009 are hypothetical (backtested) and represent a reduction in gross returns of 2.20% annually for fees and expenses, applied quarterly, which would be expected in a real-time internally managed account. Actual bond funds expenses are incorporated in the hypothetical data. (Alpha's maximum advisory fee is 2% per annum. The additional reduction of .20% is to approximate the effect of mutual fund expenses during the fourth quarter of each year not already incorporated in the hypothetical returns.) Returns assume reinvestment of dividend and interest. Performance results do not reflect the impact of taxes. The backtested data does not account for any additional fees and/or trading expenses that may have been incurred at the custodial level. The strategy calls for a precise asset allocation formula as follows: Jan. 1 to late-October: 70% intermediate-term bond funds / 30% short-term bond funds; late-October to Dec. 31: 40% intermediate-term bond funds + three power period trades using a Russell 2000 Index fund leveraged by 50%. See brochure for details. The hypothetical data uses index returns for the Russell 2000 to calculate returns in the fourth quarter of each year. The Russell 2000 is an index which cannot be used in actual investing and index funds that replicate the Russell 2000 may vary from the index returns. The hypothetical data does not include interest and dividends attributed to the Russell 2000 index. No allowance for interest/dividends earned on 60% of the portfolio during the fourth quarter is included in the hypothetical data.

**Cautions:** The investment strategy that the backtested results were based upon can (theoretically) be changed at any time with the benefit of hindsight in order to show better backtested results, and (theoretically) the strategy can continue to be tested and adjusted until the desired results are achieved. Please note that Alpha has not made any data-fitting adjustments to its managed account model. Backtested performance does not represent actual account performance, and the actual results of any Alpha client may have been materially different than the results of the hypothetical results presented. Actual accounts may use funds which deviate from the indexes represented in the model illustration. Even though the rules of the strategy are mechanical, objective, and fully disclosed, hypothetical models must be approached with caution because they are created with the benefit of hindsight and do not represent how the manager of the model may react under material economic and market conditions. No matter how positive the model returns have been over any time period, the potential for loss is always present due to factors in the future which may not be accounted for in the model. Investors should be aware that the use of leveraged funds for 20 days in the fourth quarter of each year increases the volatility and risk of the equity component of the strategy. Leverage can magnify the losses of an investment during a down market. Given the potential risks involved, strategies employing leverage may not be suitable for all investors.

## Disclosures to Alpha Bonds Strategy Data and Illustrations

The Alpha Bonds Strategy is an asset allocation strategy that combines conservative intermediate and short-term bond funds with Alpha's fourth quarter "power period" trades. The strategy determines, in advance, when to be invested in bond funds and when to be invested in equities. The investment components of the strategy are: Jan. 1 to late-October: 70% intermediate-term bond funds / 30% short-term bond funds; late-October to Dec. 31: 40% intermediate-term bond funds plus three "power period" trades using the Russell 2000 Index leveraged by 50%.

The description of the construction of the Alpha Bonds Strategy is included in this literature.

**Actual client performance:** Performance presented since October 2009 represent actual net returns of the Alpha client composite. The net client composite returns include all internal accounts managed by Alpha Investment Management at various custodians that pay Alpha advisory fees ranging from 0.8% to 2.0% annually, and as such, individual results may vary. The Alpha client composite returns are calculated using the time-weighted rate of return method. The monthly composite level performance is calculated by asset-weighting portfolio performance, using end of month market values. Trade date accounting is used for calculation and valuation purposes. The composite returns are net of all fees and trading expenses and reflect reinvestment of dividends, interest and capital gains. Performance results do not reflect the impact of taxes.

A model portfolio of the same name as this strategy may be managed by Alpha and offered by investment advisors at various trading/investment platforms, TAMPs, and/or custodians outside the parameters of the internal Alpha client composite returns. Assets invested in such model portfolios may experience significant dispersion in returns from those of the internal Alpha client composite. The causes of dispersion may include, but are not limited to, higher or lower advisory fees, custodial fees, trading expenses, the date on which a client engaged Alpha's investment management services, and the preference/availability of funds used to implement the strategy (i.e. ETFs vs. mutual funds) at the custodial level.

**Hypothetical Backtested Performance:** Returns presented prior to October 2009 are hypothetical (backtested) and represent a reduction in gross returns of 2.20% annually for fees and expenses, applied quarterly, which would be expected in a real-time internally managed account. (Alpha's maximum advisory fee is 2% per annum. The additional reduction of .20% is to approximate the effect of mutual fund expenses during the fourth quarter of each year not already incorporated in the hypothetical returns.) Actual bond funds expenses are incorporated in the backtested data. Returns assume reinvestment of dividends and interest. Performance results do not reflect the impact of taxes. The backtested data does not account for any additional fees and/or trading expenses that may have been incurred at the custodial level. Backtested performance does not represent actual account performance, and the actual results of any Alpha client may have been materially different than the results of the hypothetical results presented. The backtested data uses index returns for the Russell 2000 to calculate returns for the power period trades in the fourth quarter of each year. The Russell 2000 is an index which cannot be used in actual investing and index funds that replicate the Russell 2000 may vary from the index returns. The backtested data does not include interest and dividends attributed to the Russell 2000 index in the fourth quarter of each year. No allowance for interest/dividends earned on 60% of the portfolio during the fourth quarter is included in the backtested data.

Even though the construction of the strategy is mechanical, objective, and fully disclosed, hypothetical model results have inherent limitations due to the fact that they do not reflect actual trading and may not reflect the impact that material economic and market factors might have had on the advisor's decision-making if actual client funds had been invested in the strategy. No matter how positive the model returns have been over any time period, the potential for loss is always present due to factors in the future which may not be accounted for in the model.

**Cautions:** The investment strategy that the backtested results were based upon can (theoretically) be changed at any time with the benefit of hindsight in order to show better backtested results, and (theoretically) the strategy can continue to be tested and adjusted until the desired results are achieved. Please note that Alpha has not made any data-fitting adjustments to its backtested model. Backtested or hypothetical data must be approached with caution because it is constructed with hindsight and may not reflect material conditions that could affect a manager's decision process, thus altering the application of the discipline. There is no assurance that these backtested results could, or would have been achieved by Alpha during the periods presented.

The data used to construct the backtested results and illustrations were obtained from third-party sources, including a database provided by Callan Associates, an institutional investment consultant. While Alpha believes the data to be reliable, no representation is made as to, and no responsibility, warranty or liability is accepted for the accuracy or completeness of such information. The information and opinions expressed in this document are for informational purposes only. Any recommendation or opinion made in this document may not be suitable for all investors. The information contained herein does not constitute and should not be construed as investment advice, an offering of investment advisory services, or an offer to sell or a solicitation to buy any security.

Investors should be aware that the use of leveraged funds for 20 days in the fourth quarter of each year increases the volatility and risk of the equity component of the strategy. Leverage can magnify the losses of an investment during a down market. Given the potential risks involved, strategies employing leverage may not be suitable for all investors.

Past performance does not guarantee future performance. No matter how positive the strategy's returns have been over any time period, there can be no guarantee that the strategy will perform the same as it has in past time periods.

**Index Information:** The Bloomberg Barclays Intermediate Treasury Index measures the performance of intermediate U.S. Treasury securities with remaining maturities of between three and five years. Indexes are not investment vehicles and persons cannot invest directly in an index. The historical performance results of indices are provided exclusively for comparison purposes only, as to provide general comparative information to assist an individual client or prospective client in determining whether the performance of an Alpha strategy meets, or continues to meet, his/her investment objective(s). It should not be assumed that the performance of Alpha account holders will correspond directly to any index presented or any other comparative index. In the event that there has been a change in a client's investment objectives or financial situation, he/she is encouraged to notify Alpha or their respective financial advisor immediately. Different types of investments and/or investment strategies involve varying levels of risk, and there can be no assurance that any specific investment or investment strategy (including the investment strategies devised or undertaken by Alpha) will be either suitable or profitable for a client's or prospective client's portfolio.

*Alpha Investment Management, Inc. is a SEC registered investment advisor. Such registration does not imply a certain skill or training and no inference to the contrary should be made. Information pertaining to Alpha's advisory operations, services, and fees is set forth in Alpha's current Form ADV Part 2A, a copy of which is available from Alpha upon request. Information pertaining to any fund that is used in the execution of an Alpha strategy is set forth in each respective fund's prospectus and is available directly from the fund.*

