Now that the third quarter has come to an end, we can look back at the asset class returns over the period, and compare it to the 2nd quarter returns to gain a little insight into why we believe Frontier Based Tactical is the most effective way to construct portfolios in today's market environment.

If you remember the discussion from our last update, investors were concerned that they were not achieving returns equal to the percentage that they had in equities, and they were using the return of the S&P 500 as the benchmark for their expected portfolio return. The general feeling was that if the S&P 500 was up 15% and you were a 50/50 equity to fixed income investor, you would expect to be up in the neighborhood of 7.5%.

We went through great lengths to describe the way that "Business TV" bias would cause this expectation, and explained the return and risk benefits of creating a fully diversified portfolio. We concluded that the reason for the expectation was due to the S&P 500 winning the horse race for the quarter, and warned about using such a short time frame to judge whether or not tactical management should incorporate consolidation of assets into one class to try and "win" that race.

As the third quarter return data indicate, the attempt to "win" that horse race is a game that is played by traders, not by investors in a diversified portfolio. The decision to consolidate all assets into the S&P 500 would have put all the eggs into a basket that came in fourth out of the five equity style classes. The allocation to international (MSCI EAFE) which for the first two quarters of the year was a drag has dramatically made up ground in light of the recent domestic issues revolving around the government shutdown. The most important part of portfolio construction is controlling exposure to the asset classes while remaining in a diversified portfolio. This enables investor accounts to reflect the current environment without turning them into aggressive trading vehicles that produce extreme allocations.

Now let's look at how the portfolios were allocated over the third quarter. Before the end of the second quarter, we reduced our exposure to emerging markets and real estate in the equity sectors, and intermediate, high yield, and inflation protected in the fixed income classes. We left the overall equity to fixed income ratio at the most aggressive level per model, and we were already underweight long bonds from the first quarter transactions.

Overall, when looking at the quarterly returns for each class, we are very happy with the allocation. In an overall risk sense, we were at near maximum equity exposure while equity classes as a whole far outperformed fixed income. While our equity allocation was underweight emerging markets which outperformed domestic large cap, the underweight of real estate more than made up for the difference. With the overall weakness in all fixed income markets, we spent the quarter underweight in all fixed income classes and were completely out of long term bonds(Treasury 20+).

Going forward, given the recent strength in emerging markets, we have increased our exposure back to target levels and are watching intermediate and high yield as the next potential moves.

Jason Rolence
Portfolio Manager
Premise Capital

Performance

Time Period: 1/1/2013 to 9/30/2013

	Return	Std Dev
Barclays US Agg Bond TR USD	-1.89	4.18
Barclays US Treasury US TIPS TR USD	-6.74	7.18
Barclays US Treasury 20+ Yr TR USD	-11.00	15.57
Barclays US Corporate High Yield TR USD	3.73	4.13
S&P 500 TR USD	19.79	13.63
S&P MidCap 400 TR	23.23	16.39
MSCI EAFE NR USD	16.14	15.62
MSCI EM NR USD	-4.35	16.99
FTSE NAREIT All Equity REITs TR	3.03	19.14

Performance

Time Period: 1/1/2013 to 10/4/2013

	Return	Std Dev
Barclays US Agg Bond TR USD	-1.95	4.15
Barclays US Treasury US TIPS TR USD	-6.74	7.13
Barclays US Treasury 20+ Yr TR USD	-11.56	15.44
Barclays US Corporate High Yield TR USD	4.18	4.10
S&P 500 TR USD	20.47	13.62
S&P MidCap 400 TR	24.39	16.40
MSCI EAFE NR USD	16.05	15.48
MSCI EM NR USD	-2.36	16.90
FTSE NAREIT All Equity REITs TR	2.71	19.18

Performance

Time Period: 7/1/2013 to 9/30/2013

	Return	Std Dev
Barclays US Agg Bond TR USD	0.57	5.49
Barclays US Treasury US TIPS TR USD	0.70	8.62
Barclays US Treasury 20+ Yr TR USD	-2.70	17.39
Barclays US Corporate High Yield TR USD	2.28	3.36
S&P 500 TR USD	5.24	10.88
S&P MidCap 400 TR	7.54	14.50
MSCI EAFE NR USD	11.56	13.43
MSCI EM NR USD	5.77	18.50
FTSE NAREIT All Equity REITs TR	-2.61	20.19

Performance

Time Period: 10/1/2013 to 10/4/2013

	Return	Std Dev
Barclays US Agg Bond TR USD	-0.06	
Barclays US Treasury US TIPS TR USD	0.00	
Barclays US Treasury 20+ Yr TR USD	-0.63	
Barclays US Corporate High Yield TR USD	0.43	
S&P 500 TR USD	0.56	
S&P MidCap 400 TR	0.94	
MSCI EAFE NR USD	-0.08	
MSCI EM NR USD	2.08	
FTSE NAREIT All Equity REITs TR	-0.31	

Source: Morningstar Direct