
A CAMP KOTOK DEBRIEF PLUS SECTOR ROTATION RAMIFICATIONS

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Last week's "Behind the Markets" podcast came on the back of the annual [Camp Kotok investment retreat in Maine](#)—with one of the key portfolio managers for Cumberland Advisors, Matt McAleer, joining us for a discussion on [macro](#) positioning and takeaways from the camp discussions.

Andy Stewart, chief investment strategist at Exchange Capital Management, a fee-only financial planning firm located in Ann Arbor, Michigan, joined us in the studio to discuss his firm's approach to portfolio management. The conversation had a focus on the changing classification of sectors happening next month, with emphasis on the technology sector reclassification and how that affects his firm's thinking on portfolios.

Current Headaches in International Markets?

McAleer discussed the continued headaches being caused by international markets—the U.S. markets remain very robust and resilient. In McAleer's view, the 30 markets around the world are not trading well as he watches them making lower lows. McAleer's current worry is how long the U.S. market can remain the standout while it is near highs and these other markets are trading down.

With that background, Cumberland's current positioning in its U.S. exchange-traded fund (ETF) portfolio has 17% in cash—a larger and more defensive allocation for it than in the past—while 35% is being invested in [small caps](#), a substantial over-weight designed to lower exposure to multinationals and be more insulated from the trade-war headline risk. Cumberland's sector positioning is also tilted to more domestic-focused Health Care and Financials, with bank allocations spread out between large banks and regional banks, while being under-weight in Technology stocks.

Cumberland does not believe anyone really knows how the trade negotiations will all play out. McAleer pointed out that with China down more than 20% from its highs and the U.S. still near its highs, the market has voted who has more to lose from the trade war, and that may embolden President Trump to press trade issues further.

Bringing that trade discussion back to Camp Kotok, we discussed the trade issue a lot at camp, and some of the closest China watchers believe that while the rhetoric will ramp up ahead of the midterm elections, we are likely to see news trickling out, piece by piece, with deals for Canada to Europe and then ultimately China ahead of the midterm elections. In some ways, given where the U.S. is trading, that might be "expected," but that could be where the opportunities are, based on where Chinese markets are trading.

McAleer discussed the sell-off in China in the context of looking for an entry point. He

described such a trade as tricky to take advantage of because the sell-off has been what he describes as a “dripping down” instead of a full washout that clears out the sellers and comes with “bids wanted” signs that show the full exhaustion of selling.

Portfolio Management and Sector Rotation with Exchange Capital Management

Exchange Capital Management employs an active stock selection model for large caps and bonds, and it complements those core portfolios with ETFs for things such as sectors, small caps and international markets. This was interesting because I often hear investors say they want to use ETFs for the “efficient” [large-cap](#) space but then want to go to [active managers](#) for the more inefficient spaces such as small caps and emerging markets. Stewart’s team also uses ETFs to allocate to sectors when he does not have a high conviction call.

This sector allocation strategy led Stewart to do a lot of work around the reclassification of many large technology stocks to be included in a new Communications sector. Because there is now a large amount of money invested in technology ETFs, this is going to involve a lot of selling in some technology stocks when they get reclassified. Stewart believes the media has not focused on this story enough, and we wanted to bring this out in a bigger forum.

Right now, Telecommunications as a sector only has three companies in it—it is the smallest sector by number of companies. A number of companies, such as Alphabet and Facebook, are going to be taken out of Technology and put into Communications, and a number of Consumer Discretionary companies, such as Disney and Comcast, will join them. Stewart talked about how the media and ad-driven nature of some of these businesses makes sense to a large degree, but investors now will have to be aware of the downstream market impacts from these changes.

This was an interesting conversation both on macro-level positioning across markets and some of these micro-level decisions of classifications as well as how that can affect markets. Listen to the full podcast below.

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DEFINITIONS

Macro: Focused on issues impacting the overall economic landscape as opposed to those only impacting individual companies.

Small caps: new or relatively young companies that typically have a market capitalization between \$200 million to \$2 billion.

Large-Capitalization (Large-Cap): A term used by the investment community to refer to companies with a market capitalization value of more than \$10 billion. Large cap is an abbreviation of the term “large market capitalization”. Market capitalization is calculated by multiplying the number of a company’s shares outstanding by its stock price per share.

Active manager: Portfolio managers who run funds that attempt to outperform the market by selecting those securities they believe to be the best.