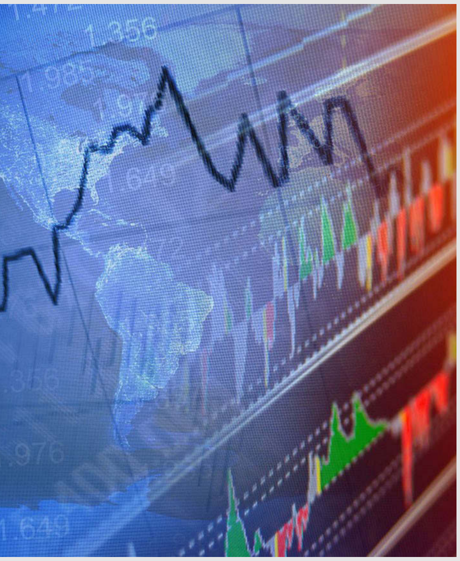
Lyons Tactical Allocation Portfolio

A Different Approach to Tactical Investing

LYONS WEALTH MANAGEMENT, LLC



A Different Approach to Tactical Investing

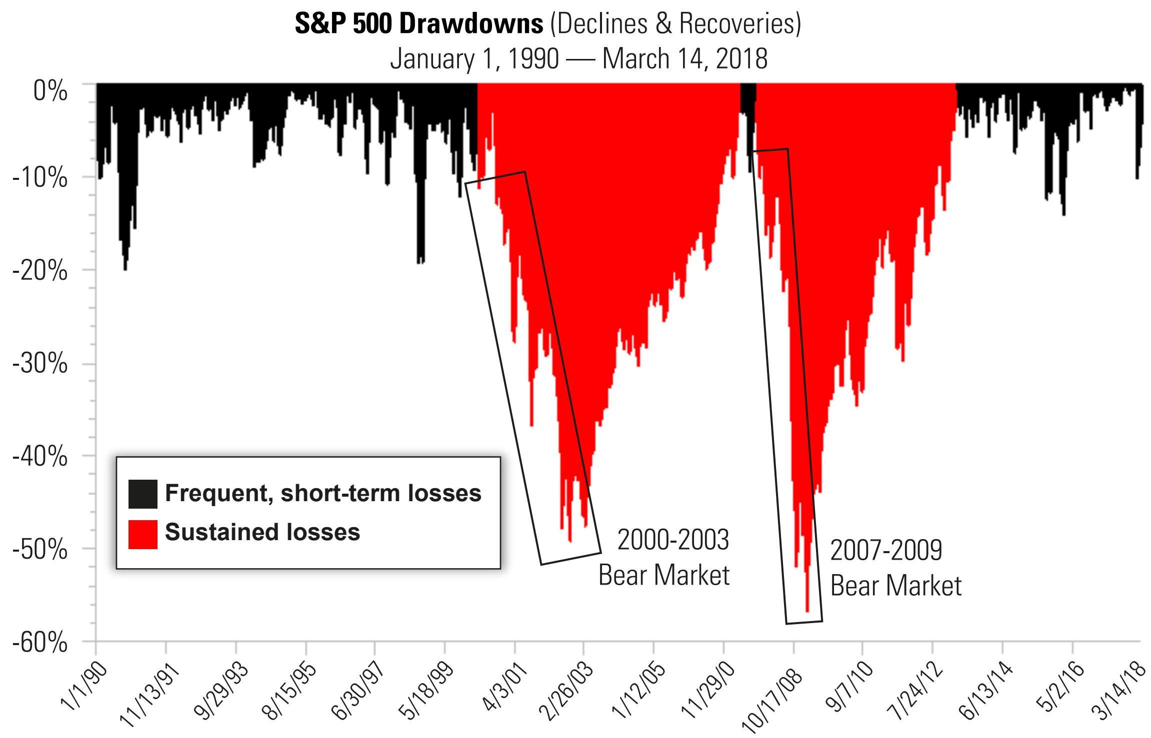
The tactical investment style is a broadly defined category in which asset management techniques vary amongst managers. Generally speaking, tactical managers attempt to miss equity market declines by rotating through asset classes or market sectors, while others short stocks in an effort to hedge. Allocations may be shifted as often as monthly or weekly. The majority of these managers use ETFs as their exposure to the stock market, and primarily rely on systematic signals to make their decisions, also known as algorithms.

At Lyons, we believe in the power of long-term equity value investing, but recognize that a buy-and-hold approach is subject to harmful losses during periods of sustained market declines. In our view, the prudent use of tactical allocation is to maximize the opportunity for investment compounding for as long as possible, and attempt to minimize the impact of only the larger market declines that harm cumulative returns.

Not All Market Declines are Equal

On average, the deeper the market decline, the longer it takes to recover. The market frequently endures small declines that are brief and quickly retrace to breakeven. For example, a 5% decline historically averages just 47 days in length when measured from peak to trough.[1] Additionally, the greater the loss, the larger the gain needed to recover and break even. While a 10% loss requires an 11% gain to break even, a 50% loss requires a 100% gain to recover.

Bear market declines occur less frequently, yet are far more severe and potentially damaging to investor portfolios. The two bear markets of the 2000s averaged a decline of 52% and took 3 ½ years to recover.[3] Eleven bear markets have occurred since 1950 — an average occurrence of once every six years. Such multi-year market declines stop investment compounding. The years spent holding equities during decline and recovery periods can have a devastating impact on cumulative investment performance.

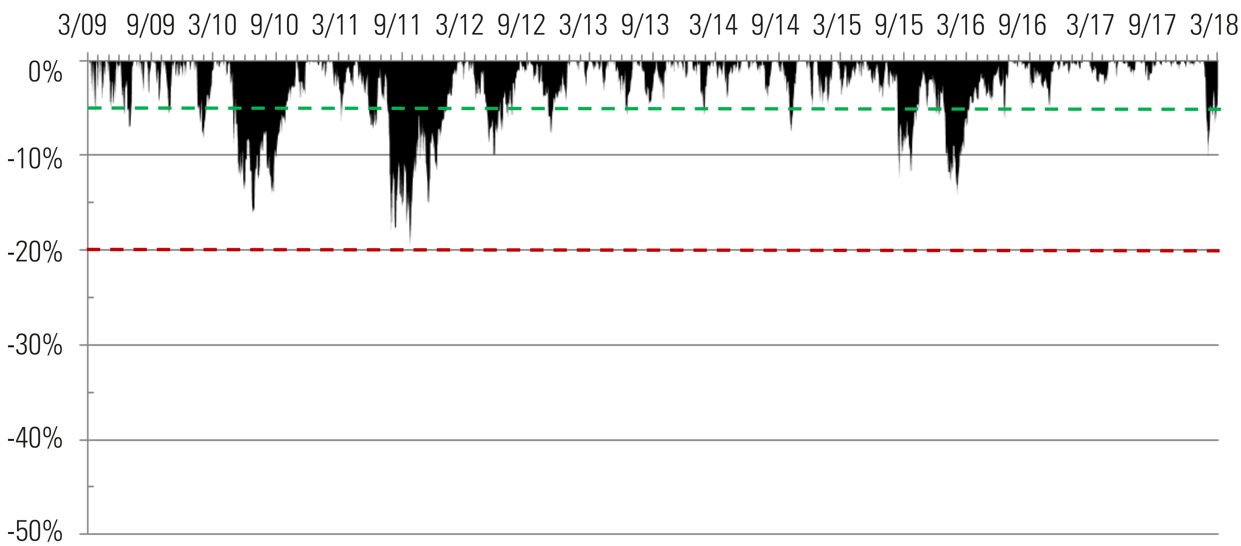


Graph of hypothetical investment in the S&P 500 Total Return Index from 1/1/1990 – 3/14/2018 and assumes reinvestment of dividends. The referenced indices are shown for general market comparisons and are not meant to represent the Fund. Investors cannot directly invest in an index; unmanaged index returns do not reflect any fees, expenses or sales charges.
Source: Graph created by Lyons Wealth Management with Zephyr StyleADVISOR using data from FactSet

Sustained Declines Matter Most

We observe that 5-10% pullbacks, and double-digit corrections, occur frequently during bull markets. Most recently, five corrections of at least 10% have occurred during the 2nd longest bull market in history that began in March 2009. These relatively benign market declines have little impact on a long-term, buy-and-hold investor. However, they often spark fear and emotions that trigger irrational investment decisions, increasing the risk of missing upside if the correction reverses course. This whipsaw effect may be magnified by greater frequency or size of allocation shifts.

S&P 500 Drawdowns (Declines & Recoveries)
March 9, 2009 — March, 14, 2018



Source: FactSet and Zephyr StyleADVISOR. Past performance does not guarantee future results. You cannot invest directly in an index.

Like a ship at sea that navigates turbulent waters and changes course only to avoid severe weather, we believe we should stay the course and sail through choppy markets, seeking to steer around extreme conditions only. A defensive strategy that focuses on large, painful market drawdowns may reduce the whipsaw effect and offer a better risk/reward profile.

The Lyons Approach

The Lyons Tactical Allocation Portfolio is is based on our belief that equities offer a favorable risk/reward trade-off over time, and that minor market gyrations and disruptions do not warrant frequent defensive shifts. Our value investing philosophy is that we have the potential to outperform by investing in the stocks of strong companies available at good prices, and seeking the relative safety of a defensive allocation only when we perceive market risk to outweigh the reward.

Our Approach: Offense First, Defense Next

During bull market cycles, we strive to maintain a full allocation to equities. Most tactical portfolios focus so heavily on defense that they underperform during normal market conditions. We focus on offense first, building a portfolio of individual, dividend-paying stocks. Then we look at defense, seeking to navigate only sustained market drawdowns. Our goal is to participate in long-term equity market growth by being fully invested, yet offer the potential to avoid sustained declines.

Stock Selection

We seek to buy high-performing companies at what we believe are bargain prices. We are interested in those companies who most efficiently generate cash on the resources they put to work, and who are undervalued relative to peers. We are looking for strong performers priced below their intrinsic value due to short-term market fluctuations.

In our view, a company should be evaluated as to how efficiently it can generate cash, the reliability of its returns, and—most importantly—on how much it costs.

We focus our performance analysis on cash flow rather than earnings, which may be manipulated by company management to distort true performance. We invest in large dividend-paying companies, as they tend to be more stable during periods of market volatility. Only stocks that meet minimum requirements for market cap and dividend yield are included in our universe.

We evaluate companies on a relative basis using a series of rank orders, seeking to highlight those companies offering the best relative combination of high performance and low price. Separate performance and valuation rankings are combined and used to build our equal-weight equity portfolio.

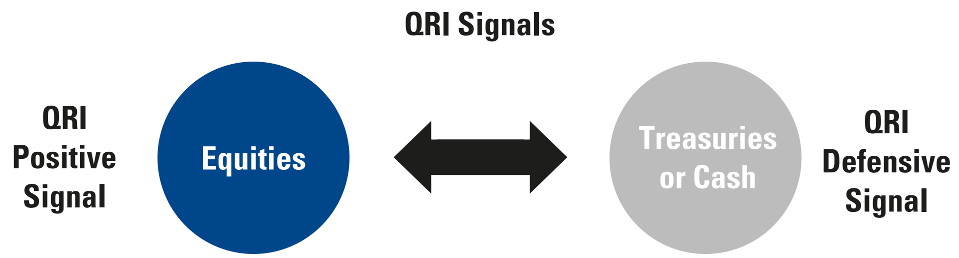
Downside Protection

Quantitative Risk Indicator (QRI)

We've constructed a systematic approach intended to capitalize on the fundamental market price shifts that often precede bear markets. We call this the Quantitative Risk Indicator (QRI). The QRI focuses on minimizing the impact of equity bear markets. It assesses market conditions on a monthly basis and drives our allocation between equities and Treasuries or cash.

Based on such measures as market trend, momentum, and consumer sentiment, the QRI helps us establish which direction the market is moving, how quickly, and if the movement bears conviction. We measure data sets over multiple time intervals. For the QRI signal to change, data sets must collectively meet fixed thresholds set in our proprietary risk model.

The QRI is a relatively slow-moving signal designed to react only to extreme risk sentiment. We want to reduce the potential for whipsaw that may result from reacting too quickly to a short-term dip.



To reiterate, we are concerned only with the more rare, prolonged periods of extreme decline. With this in mind, we anticipate shifting defensive only a few times per decade, allowing us to focus on offense and achieving the long-term benefits of compounding returns.

Building the Portfolio

We begin with a universe of stocks that meet dividend yield and market capitalization parameters. Stocks meeting our criteria are then ranked by measures of company performance and the stock's relative valuation. From the upper rankings, we build a concentrated portfolio of stocks offering the best relative combination of performance and value.

Once our offense is in place, we evaluate the QRI each month to determine portfolio allocation. When the QRI generates a positive signal, we remain fully invested in our equity portfolio. If a defensive signal is generated, we will allocate fully to U.S. Treasuries and/or cash.

We rebalance our equity portfolio quarterly when maintaining a long-term equity allocation. By repeating our equity selection process, we retain any holdings that still represent a good value according to the model, and replace others—even well -performing companies—with new and potentially better opportunities.

1. Construct Concentrated Equity Portfolio

- Screen for stocks that meet dividend yield and market cap criteria
- Rank by company performance and relative valuation measures
- Evaluate rankings and select stocks based on further analysis

2. Assess Market Risk

- Evaluate market risk each month using the QRI
- If model signal changes, shift portfolio allocation accordingly between stocks and bonds

3. Rebalance Portfolio

- When offense is maintained over long time periods, rebalance equity portfolio quarterly by repeating systematic equity selection process

How We are Different

Individual Stocks

We believe a value-based stock selection process has the potential to outperform over the long term. Whereas a conventional tactical strategy that uses index ETFs must rely solely on its risk model to achieve its investment objectives, our active management approach and high active share offer an additional means for long-term performance.

Dividend Focused

Dividends have historically accounted for a significant portion of equity returns, even in bull markets. By investing only in stocks that meet our minimum dividend yield criteria, we seek to enhance the power of compounding on cumulative returns.

From 1990-2013, dividends accounted for nearly 40% of the annual returns of the S&P 500 Total Return in non-bear market years.[4]

Lower Internal Expenses

By investing in individual stocks, we seek to eliminate the layers of internal expenses embedded in ETF portfolios.

No Leverage or Shorting

We avoid the use of leverage and shorting, both which can create an unfavorable risk/reward profile and lead to significant underperformance, particularly when combined with frequent allocation shifts. Whipsaw is exaggerated by leverage.

Defense Focused on Sustained Declines Only

With the QRI intended to react only to large market declines rather than short-term pullbacks, we believe we can reduce the likelihood of the whipsaw effect that often results from more frequent allocation shifts.

Potential for Relative Tax Efficiency

We anticipate rare defensive shifts, allowing us to maintain our equity allocation over multi-year periods. This creates the opportunity for long-term capital gains if we hold a stock longer than one year. By contrast, frequent allocation shifts ensure larger generation of short-term capital gains.

Lyons Wealth Management, LLC

Forward Thinking. Proactive Management.

Lyons Wealth Management, LLC is a registered investment advisor based in Winter Park, Florida that serves as an asset manager and sub-advisor to a broad range of clients and investment professionals. Our mission is to create unique investment solutions that help our clients meet their long-term goals. We take pride in complementing our investment programs with quality service and support.

Conventional buy-and-hold investment strategies can fail to keep pace with rapid globalization of economies and financial markets. We seek to innovate forward-thinking investment strategies that address the needs of the evolving investment landscape. Accordingly, Lyons Wealth applies a proactive investment management philosophy to navigate diverse market conditions.

Sources:

[1] Capital Research and Management Company

[2] JP Morgan Asset Management: Guide to the Markets 1Q 2014

[3] Fund Evaluation Group, Standard & Poor's, and Lyons Wealth Management using data from Zephyr StyleADVISOR. Recovery periods are stated as the time needed for the S&P 500 Index to reach its previous high water mark.

[4] Standard & Poor's

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