



AlphaSector™ strategies protected investors from extreme volatility while delivering market-level returns during turbulent 2011

Key takeaways:

- Volatility dominated the markets in 2011, and in response the AlphaSector strategies adapted to market conditions by aggressively “de-risking.” AlphaSector Premium Index reduced overall volatility by 43% versus that of the S&P 500 in 2011.
- AlphaSector Premium Index returned 1.7% for the year, lagging the S&P 500’s modest 2.1% gain by only 40bp.

Sustained Market Volatility was the major challenge to investors in 2011

In the equity markets, 2011 may have ended nearly flat, but investors experienced an uncomfortable up-and-down ride. Volatility rattled the markets, especially in the second half of the year:

- The first quarter of 2011 was **the best Q1 since 1998** for the S&P 500 TR Index. The third quarter was the **worst Q3 since 2008**.
- The VIX reached a high of 30 or more during twenty weeks in 2011, a level of volatility exceeded in only two periods since 1989: the 2002 and 2008-2009 market crashes.
- Between August 1 and December 1, the S&P 500 saw **eight declines of 5% or more and eight advances of 5% or more**. The total of sixteen such movements means that, on average, big swings were a weekly occurrence.

The headlines echoed the market swings and added to investor uncertainty. Stories on the sluggish economy at home and abroad, US government deficits, and the Euro credit crisis added to investor uncertainty. Investors responded to the heightened risk: according to Morningstar, US stock mutual funds lost \$101 Billion during 2011, the worst year since 2008.

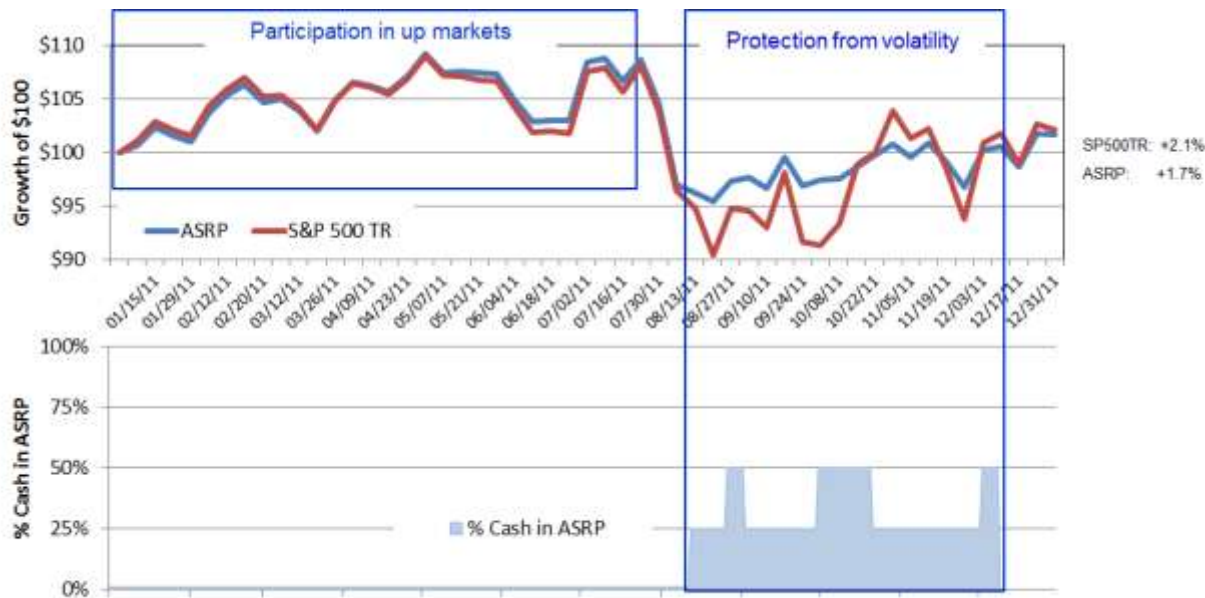
Although the S&P 500 TR Index advanced 2.1% for the full year 2011, that seemingly dull outcome conceals a year of volatility and anxiety for most investors.

The AlphaSector strategies protected clients from the worst of market volatility

A key aspect of the value proposition of AlphaSector is the ability to “**de-risk the portfolio**” in volatile and negative markets. In an extended bear market, as in 2008-2009, the goal is to reduce capital loss. In periods of up-and-down swings such as 2011, the dual objectives are to 1) position the portfolio defensively to move quickly to cash if the markets deteriorate significantly, and 2) to reduce volatility and its negative impact on clients.

The AlphaSector Premium Index achieved that objective, as the following chart shows:

When the S&P 500 Total Return Index (red line) showed extreme volatility, the AlphaSector Premium Index (blue line), provided a smoother ride for investors and yet delivered virtually identical returns.



Source: Morningstar, F-Squared Investments

- When volatility spiked in late July and August, **the AlphaSector Premium Index reduced exposure to the most volatile sectors and assumed a defensive part-cash position.** Cash remained in the portfolio, at 25% or 50% weighting, into early December.
- The AlphaSector Premium Index ended 2011 with a one-year return of 1.7% versus 2.1% for the S&P 500 Total Return Index. AlphaSector Premium therefore came within 42 basis points of the S&P return, **but AlphaSector had 43% less volatility for the year than the S&P.** Standard Deviation for 2011 was 9.1% for AlphaSector Premium versus 15.9% for the S&P 500.
- Using Morningstar's US Large Blend Funds as a peer group, the AlphaSector Premium Index outperformed the 1.5% return threshold for Top Quartile performance and strongly exceeded the -1.2% return of the Peer Group Average. *Note: as an index, AlphaSector Premium does not reflect expenses.*

Delivering on the real needs of investors:

- Most investors experienced 2011 as a very rough ride. They needed protection from volatility, which can create anxiety and weaken commitment to investment plans.
- AlphaSector delivered a measurably smoother, less volatile investing experience in 2011. For advisors, this can help you keep clients on track, preserving your time to build their portfolios and your practice.

See important disclosure (attached).

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The S&P 500 Index is a broad-based unmanaged index of 500 stocks, which is widely recognized as a representative of the equity market in general.

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The peer group is comprised of all open end mutual funds tracked by Morningstar that, according to Morningstar, meet the listed investment category and was selected as a relevant comparison due to the similarity in investment objective of the profiled F-Squared index.

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Sources: Morningstar, NASDAQ OMX, F-Squared Investments

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