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THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

Limiting Downside Losses by Managing Risk to Capital

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SECTOR — GENERAL INVESTING

TWST: Could you tell me a little bit about WBI?

Mr. Schreiber: WBI is a firm that was founded in 1984. We manage, as our first priority, risk to capital. We believe limiting the downside losses in bear-market cycles can improve a client's ability to compound and grow capital. We view this actively risk-managed approach as a superior alternative to traditional passive or allocation approaches. Our approach focuses on managing the risk to capital with the hope of effectively preserving a portfolio's ability to compound, whereas traditional passive approaches that focus on low-cost passive index products can hand investors the full market losses on the downside as they try to obtain full market gains on the upside.

We believe a combination of good market gain participation and smaller losses in down market cycles tend to allow investors to stay more comfortably invested in both good and bad market cycles. Traditional approaches using passive products and allocation approaches are dependent on conventional investment wisdom that encourage investors to buy and hold. We also have found over the last 35 years of working with literally thousands of clients that they don't actually buy and hold when normal bear-market declines start to exceed 30% to 50%. The fundamental premise of investing is to buy low and sell high; yet our experience shows that investors have historically bought high and sold low. They fail to buy and hold as bear-market losses drive them from the markets.

And then, they wait too long to get reinvested after locking in big losses, missing out on powerful returns promoted by early bull-market relief rallies. Investors often tend to sit on the sidelines after taking losses for three or four years and only invest after bull-market trends are firmly established. So we've built a process that we think is more effective for clients by actively managing risk and loss in an effort to optimize the return sets between up- and down-market capture.

TWST: Do you think one of the reasons that they sometimes don't hold on to stocks for long enough or sell too soon is that they are barraged by different business news stories on TV or elsewhere, and they either think they want to get in on something early, or they want to sell things they think are high?

Mr. Schreiber: I think that people are seduced by the siren song of an elongated bull-market cycle like we're in now, currently lasting more than eight years coming off the bottom in March 2009. We're essentially eight years into this bull-market cycle without a major correction, and people have forgotten about the battering losses that they took in 2008, early 2009. The media focuses on bull-market returns and so do investors. Even as markets become extremely overvalued, investors stay focused on chasing returns, forgetting to pay attention to the risk side of the equation.

Recently, the siren song of the media is that passive indexing has been working very well, and low cost is better. So in this kind of environment, why pay for active management as the markets continue to reinforce the passive story by going up most days? This sentiment tends to happen in every bull-market cycle as investors forget about the bear-market losses they incurred and end up chasing returns more because they came late to the bull-market party. Unfortunately, they set themselves up for repeating the same mistakes because they buy high, not low. They set themselves up for the greater fool theory, which assumes there is always someone who is dumber than you that will pay a higher price, so you can get out with a profit.

As cycles mature, investors can fall into the trap of believing markets will continue to rise forever. Sometimes, the folks who are going to pay the higher prices don't show up when you need them, and you end up taking the significant losses. News media reporting favors the trend and can play into overpromoting the current cycle. People can mistake the one-sided news cycle as advice, but it's not advice and, therefore, is not the basis for developing an appropriate way to invest money.

Highlights

Don Schreiber Jr. discusses WBI Investments. Mr. Schreiber's first priority is to manage risk to capital. He believes that limiting downside losses in bear markets can improve a client's ability to compound and grow capital. Mr. Schreiber feels this risk-managed approach is superior to traditional passive approaches, and it allows investors to stay invested in both good and bad market cycles. In the current elongated bull market, Mr. Schreiber thinks many investors are chasing returns and forgetting about the risk side. Based on his view of the economy, Mr. Schreiber advises investors to become defensive by investing in sectors and industries that tend to outperform in market declines..
Companies include: Chubb Corporation (NYSE:CB); Lockheed Martin Corporation (NYSE:LMT); Waste Management (NYSE:WM) and DTE Energy Company (NYSE:DTE).

TWST: Did you want to highlight a company you find interesting?

Mr. Schreiber: Right now we have the economic backdrop where the hard data on GDP and inflation is showing continued weakness. Gross domestic product, or the economy's growth, continues to slow, confirming that we're getting weaker, not stronger, and inflation has been really subdued. There seems to be a general consensus among economists and the Federal Reserve board that the hard data is not telling the true story of economic growth, that soft data based on perception is more credible. They have tried to assuage fears about hard-data weakness by telling the public that the weakness shown by the hard data is transitory, a word the Fed used nine times in the minutes of their most recent meeting. We believe this is a continuation of the hopeful rationalization that people have been using every single year for the last eight years, indicating that the economy's going to get stronger when, in fact, it continues to get weaker.

The Fed is doing something very dangerous, in our opinion. They're raising rates at a point in time when the markets are extremely overvalued based on the trailing p/e multiples. Markets are about as overvalued as they have ever been. The only time they've been more overvalued than today's markets was in 2000, just before the dot-com bull-market bubble burst. If the Fed is wrong about hard data and the economy continues to falter, raising rates is a very high-risk endeavor and will likely lead to a recession and market correction.

So we would look to start to play some defense by investing in sectors or industries that tend to outperform in market declines. When you get defensive in investing, we favor higher yielding dividend-paying stocks that have really strong balance sheet and income statement fundamentals, who have a current revenue and earnings profile that is growing as opposed to falling. And so instead of the hot growth stocks that everybody has been enamored with lately, we would be investing in the more defensive names. That's where we think the market is going to rotate to next as it becomes obvious to more and more people that the economy is not going to get to a 3% growth rate anytime soon, that the pro-growth policies laid out on President Trump's platform are going to be very difficult to get through the dysfunctional political situation in Washington, and the markets could reverse course.

"When you get defensive in investing, we favor higher yielding dividend-paying stocks that have really strong balance sheet and income statement fundamentals, who have a current revenue and earnings profile that is growing as opposed to falling."

We like **Chubb Limited** (NYSE:CB), which is an insurance company. Currently, it has a yield of 1.93%. **Chubb's** financials are in really good shape, growth trends in revenue and profit are positive, and the insurance sector is a more defensive group that we think will do better in challenging market conditions.

"There's also some very interesting things going on in terms of arms sales to overseas entities and countries. We've seen most recently President Trump came back from his first international trip with huge defense contracts in hand for U.S. companies."

1-Year Daily Chart of Chubb Corporation

Chart provided by www.BigCharts.com

TWST: Do you want to talk a little bit about what you think some investors don't realize about Chubb Limited that they should know about it?

Mr. Schreiber: Chubb is a midcap stock. It's a "Tiffany" insurance company. They're one of the insurance companies that higher net worth clients tend to use more frequently. They have very good profit and earnings because they're essentially a "Cadillac" provider, and they charge for it. So they're a company that has pretty strong growth prospects and financials that should do well even in a challenging market environment.

Because it's not one of the largest players in the industry, it may not be a company that people are aware of. They principally do homeowners' insurance or property and casualty coverage, and they're very good at it. They've been doing it for a very long time. So if you're looking for some downside insurance against a market decline, I'd pick **CB**.

TWST: Did you want to mention another company?

Mr. Schreiber: Lockheed Martin Corporation (NYSE:LMT), it's in aerospace and defense. We think if the president is successful in increasing our defense footprint, **Lockheed Martin** will continue to benefit as one of the world's go-to aerospace and defense contractors. It has about a 2.6% dividend yield. Again, strong fundamentals, good growth trends, and they happen to be in a sector that should do well regardless of what's going on with the economy.

As the administration bolsters the United States' defenses and spends more money with companies like **LMT**, this sector becomes more attractive. And we believe this defense stock is going to be an excellent choice. If the market holds together and continues to march higher, **Lockheed Martin** should benefit from the increased defense-spending footprint. If the market goes lower, it should do just great as a defensive play because defense industry funding by the U.S. government should be largely unaffected.

There's also some very interesting things going on in terms of arms sales to overseas entities and countries. We've seen most recently President Trump came back from his first international trip with huge defense contracts in hand for U.S. companies. **Lockheed Martin** could be one of those companies that benefit.

1-Year Daily Chart of Lockheed Martin Corporation

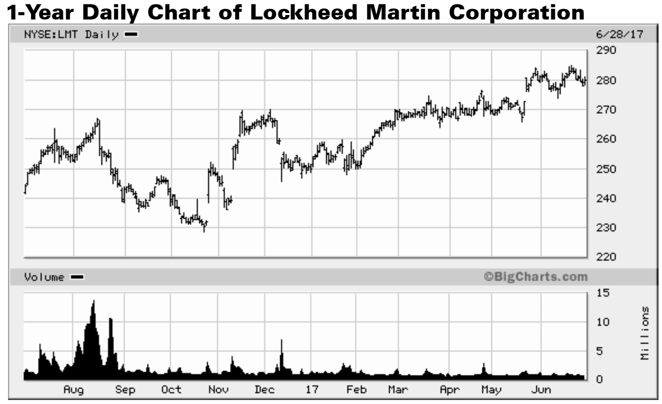

Chart provided by www.BigCharts.com

TWST: It also has some non-military-type products that it sells; is that right?

Mr. Schreiber: Yes.

TWST: Are those industries also potential growth areas for them?

Mr. Schreiber: Yes, they are. I think that the whole aerospace industry is also going to be good. **Lockheed Martin** is a very large diversified company with a big footprint across the aerospace and defense industries, and they're going to be well-funded in terms of what goes on over the next three to five years. So it should be a company that continues to grow quite nicely, and it is a very competitive company within the industry.

TWST: Did you want to mention another company?

Mr. Schreiber: The third company that I would mention is **Waste Management, Inc.** (NYSE:WM). Again, a little bit above-average dividend, 2.3%. This is a company that is responsible for all forms of waste management. It's the largest player in the industry, and regardless of what happens to the economy, not only do people need to take out the garbage, but someone needs to recycle it and take it away, and that's what **Waste Management's** job is. It's a company that has a very steady profile and, again, with the higher dividend. It's in the type of industry sector that we think will be a good defensive play should the markets decide to retreat here.

1-Year Daily Chart of Waste Management, Inc.

Chart provided by www.BigCharts.com

performance profile. So anytime we look for a stock to invest in, we look at the fundamentals to make sure that they are in a solid financial position with positive growth trends.

And once again, utilities tend to be a defensive play that tends to do very well as people cycle from growth into yield-oriented stocks to stay invested. Pension funds and institutional investors that change allocations to remain fully invested as markets decline typically cycle into these type of stocks, so they tend to hold up extremely well. **DTE** has been performing well against their peer group, and we think that should continue.

As economic and market conditions change, utility stocks are a good way to play defense because their customers have to pay their utility bills to keep the lights on. So that's four different industry sectors, all of them defensive positioning, playing a little defense, but at the same time, I think, playing some offensive exposure within your portfolio — if markets should retreat from all-time highs.

TWST: The need to play a little defense, is that just as important for the retail investor as the institutional investor?

Mr. Schreiber: Absolutely. For a retail investor, it's even more important. Retail investors tend to head for cover in big market declines. If the market does decline, we should expect to get the average bear-market decline, averages of 40% to 50% like we saw from 2000 to 2002 and then again 2008 through early 2009. Those are just normal bear-market cycles that occur with regular frequency about every six years, and we

"The markets tend to convince people in late-stage rallies that investing is easy, that the markets continue to go up, and they will continue to go up forever. And that's never true."

TWST: Where do you see some of their future growth? Might they do more globally or do more with renewable energy, or maybe do some mergers and acquisitions?

Mr. Schreiber: They probably will do all of those things. The renewable energy — the cogeneration or waste-to-energy plants they have turn municipal waste into renewable energy. They're the leading provider of waste management services in North America. They're also aggressive in trying to find the best way to dispose of and recycle waste, so I think they continue to have a pretty steady source of revenue. The world is not making less waste; it's making more.

TWST: Did you want to mention one final company?

Mr. Schreiber: One more is **DTE Energy** (NYSE:DTE). It has about 3% dividend yield. It's a multi-utility located in the upper Midwest. We like the above-average yield and good

have been eight years without a correction.[1] We think it's about time to expect something. With higher yielding defensive stocks, investors could get paid to wait to see what market trend develops over the next six months.

TWST: When you talk with those investors who are in the Baby Boom generation that are either in retirement or nearing retirement, what are some of their concerns as they look to the stock market — the way it might be this year or next year?

Mr. Schreiber: As investors approach retirement or start taking income withdrawals from their portfolios, they have to be very cautious not to lose capital. Investors at this stage tend to get more focused on not losing too much money in the down markets. They typically need a portfolio focused on capital preservation and relatively high current income. These investors may favor high yield bonds or corporate bonds and higher yielding dividend-paying stocks because their investment portfolio needs to help support lifestyle expenses.

And so one other thing that I have heard over my whole career is that when they get to that stage, they want to position their portfolio so they don't lose too much money. They often say, "I am willing to invest, but don't lose my capital because we can't go back to work for another 30 years or 40 years to rebuild our assets." So one of the conundrums that you have as an adviser in later-stage bull-market rallies is to help investors stick with their natural risk profile and not get seduced by the siren song of rising returns.

The markets tend to convince people in late-stage rallies that investing is easy, that the markets continue to go up, and they will continue to go up forever. And that's never true. It just looks that way for a short period of time, and because we are now in an elongated bull market, it has looked that way for an extra two or three years beyond what is normal. And so the important thing for retail investors that are in the Baby Boom-plus generation is to make sure that they are not discounting their natural inclination to avoid risk at this stage. These defensive plays are good plays because they happen to have a pretty good yield in defensive sectors that tend to go down less in a bear market.

TWST: If there is the need to do defensive action on the part of investors, where does that leave a lot of the Millennials, many of whom haven't really begun to invest that much in the market, and probably many of them would like to invest if they had the available cash?

Mr. Schreiber: Millennials are younger emerging investors who typically have less capital to invest. When you have less capital at risk and lots of time to save, you tend to be less concerned about downside risk. We found investors start investing at about age 25, and it normally takes until about 45 to be able to accumulate a pretty good-size nest egg. During this part of their investing life cycle, they tend to have a higher risk profile than average. And they have historically favored investing in growth stocks.

The thing that investors don't understand is that investing successfully is all about compounding and getting to retirement with the largest capital base to produce income. The industry and markets teach investors to focus on the price return that you get on a given security versus the price return of the indexes or markets. Yet, investing success is all about compounding successfully. Albert Einstein said that compounding is the eighth wonder of the world — the most powerful investment force in the universe.

The way to promote compounding best is to reduce losses in down markets, preserving your ability to compound on a larger capital base. Dividend reinvestment, which Millennials will be able to do for decades in the future, is a very powerful compounding accelerator, as you reinvest your dividends and the new shares that you buy spin off even more dividends, helping to promote a larger capital base. Third, you want to invest in stocks that have above-average price-appreciation potential. Price appreciation is important but only one-third of the total equation. So compounding with dividends will help you achieve success much more effectively than hot growth stocks that may offer flashy price appreciation from time to time.

Our research indicated that Dow Jones bear market declines were up to seven times more damaging to an investor's ability to succeed than bull market gains (1950-2016). We have also found that if you can keep down-market losses to 20% or less, then the up-market returns of bull markets become extremely powerful. When you start to lose more than 20% of your capital by trying to stay invested to participate fully in up-market trends, you tend to have made a poor exchange of less powerful bull-market returns for the capital-damaging bear-market losses. The historical six-year profile of bear-market losses, averaging 40% to 50%, is a bad exchange, because while bull-market returns will allow you to recover your capital, it's very difficult to achieve a targeted rate of return high enough after a 50% loss for investors to achieve their goals. In our opinion, the number of times an investor should take a 50% loss over their investing lifetime — never.

TWST: One final question, from the point of view of government, what one or two things could it be doing to help investors in the next one or two years?

Mr. Schreiber: I think that the policy prescription that the Trump administration ran on and is trying to get implemented is what the economy and markets need to move forward in a more positive and productive way. The pro-growth policies of corporate and personal tax reduction, infrastructure spending, reduced regulation and more balanced trade should be good for economic growth. I believe this to be the right policy prescription, and my job leading WBI's money management team is to help investors invest more successfully. With an extremely weak economy in the U.S. and even weaker worldwide, the risk is increasing that the economy could falter and markets could fall hard.

The damage from the financial crisis still lingers because the U.S. and the rest of the world has not achieved enough growth to heal the worldwide financial system. Eight to 10 consecutive quarters of compounded economic growth above 3% is what the economy needs to recover. But we haven't had even one quarter with 3% growth in this recovery. This is the weakest economic recovery coming out of a recession in history.

Trump and his administration have patterned his pro-growth policy based on what Ronald Reagan used to lift the U.S. economy out of stagflation[2] and gave us the best economic growth cycle and the best bull-market return set in history. I think that we need to get some of those policies enacted. We already have seen how it worked for the American people under Reagan. It worked fantastically well to give us an economic recovery and to improve investor returns, and so those are the things that I'm interested in.

Mr. Trump is president of the United States of America, and the dysfunction and obstruction need to stop to let him attempt to implement his agenda — whether you like him or not. Reducing regulation, enacting pro-growth policies will help lift the economy to more growth and help sustain the bull market. And I'm really concerned that if they don't happen and the economy continues to weaken, we've got some really major problems and the market's in huge trouble.

TWST: Thank you. (ES)

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Notes:
1 Lynch, Peter. Bear Market Musings. PBS. Public Broadcasting Service, Web. 02 June 2017.

2 Stagflation: persistent high inflation combined with high unemployment and stagnant demand in a country's economy.

The views presented are those of Don Schreiber, Jr. and should not be construed as investment advice. Don Schreiber, Jr. and/or clients of WBI may own stock discussed in this article.