PLAYBOOK/RISK

Q3 2013

Risk Factors are the "ingredients" of asset classes and many investments share common ingredients but in different quantities.

Example: High Yield

Ultimately, we are trying to answer 4 key questions:

1. **How much risk am I taking?**
2. **What are the primary sources of risk in my portfolio?**
3. **Do we like those risks and resources?**
4. **What is the best way to improve our exposures?**

ABOUT US

Every asset class should have a specific role in the portfolio. Understanding its unique "ingredients" and how they relate to other assets is critical to risk-efficient portfolio construction.

This understanding of underlying risk factors allows us to have stronger views on the relative valuation and contribution each asset makes to the portfolio. For example, if equity risk dominates High Yield, would we prefer to own Equity directly, or do we think High Yield can provide much of the equity "upside" without having as much "downside"? Every asset class undergoes this type of evaluation as we force assets with similar risk exposures to compete for a slot in the portfolio. Likewise, we gain greater insight into sources of true diversification.

> **Our first question is always, "What happens if we're wrong?"**

Summit's risk model assumes that investment returns are not normally distributed; extreme losses are larger and more frequent than extreme gains. By incorporating non-normal distributions, we gain greater insight to how much "tail risk" various investments contribute to the portfolio. A portfolio that appears to provide diversification through the lens of traditional standard deviation can often be shown to provide little in the way of diversification against major market events.

OUR PHILOSOPHY

Markets are micro-efficient, macro-inefficient. We study market valuations to steer us to asset classes to overweight and underweight. We incorporate more asset classes into our discussion than most. We are risk-driven. Our first question is always, "What happens if we're wrong?"

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