Riding High Yield Bond Funds

As investing in high yield bonds can generate equity-like returns with less risk, trading in a diversified pool of high yield bonds can deliver even more consistent performance. Ralph J. Doudera, portfolio manager of the Hundredfold Select Alternative Fund, has spent two decades in perfecting his investment approach with technical analysis and alternative investment strategies.

What is the history of the Hundredfold Select Alternative Fund?

Hundredfold Advisors is the sub-advisor for this particular fund and is owned by Simple Distribute, a public charitable foundation, and has been advising the fund since its inception in 2004. Ralph Doudera has been the key advisor for Hundredfold, and has been actively involved as an adviser since 1988.

How would you define your investment philosophy?

Our belief is that the most profitable way of managing money with limited risk has been trading high yield bonds. Generally, trading high yield bonds carries lesser risk than trading in stocks because their volatility is limited.

Our primary investment objective is to get steady returns without having a drawdown or significant downturn of any consequence. What we do not want to do is get hurt in bear markets.

What is your investment strategy?

We have a core strategy in our fund, essentially a corporate high yield bond trading strategy for 60% of the portfolio, which we supplement with a non-correlated investment for the other 40%. In the non-correlated portion we are looking for other mutual funds that have strategies that are independent of the market cycles.

Next, we add to our portfolio certain kinds of other funds such as long/short strategy, an absolute strategy or merger strategy that can add more alpha or additional returns that are not linked to market cycles. We pick some of those funds as our alternative strategy but we won't necessarily stay with them long term if they do not perform well. So, we rotate them out and find out other managers who we think are doing better or have a better theme for the current market environment and replace the ones that are not doing as well.

Another part of the alternative portion in the fund is the presence of three different very short term stock trading strategies. In this way, we designate 10% or 15% of the portfolio to an equity trading strategy depending on the market conditions. In addition to that, we may take a position in gold or go long or short currencies.

We are opportunistic in our approach and frequently change the tactics within the fund.

What is your investment process for trading high yield bonds?

We basically have three different ways in which we trade high yield bonds. First, in the fund we will hold a core position in yield bond funds as long as the trend in the intermediate term is favorable to high yield bonds.

Second, we supplement that with the trading in high yield Exchange Traded Funds or ETFs that are more liquid. There are several ETFs available for us to trade as well but they trade a little differently. And finally, from time

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to time we use the derivatives based on collateralized high yield bonds known as CDS that are generally not available to the public.

We often do not use all of our cash and also can do some leveraging inside the fund.

How do you evaluate other high yield funds?

We first look at the fundamentals of the economy and spreads in the bond market. As of today, the high yield bond index shows a premium of 750 basis points over the U.S. Treasuries of similar maturities. Historically, the higher the spread the higher the potential is in the high yield bond market but there is also more risk. We are always looking to ride the major trend.

Until that trend turns, we would not be interested in taking a position in other high yield bond funds. We have our proprietary signals that indicate to us when to buy and sell bond funds. When we get a buy signal, we can move pretty quickly to a fully invested position.

What are the analytical steps that make up your research process?

We are totally technical in our investment approach and not fundamental. We do not take a position in anything that we think fundamentally is going to do one thing or another. We use technical trading models for everything that we do, whether it is trading currencies or financial assets or high yield bonds.

But we do take fundamentals into our strategies by trying to determine which market sectors are going to give us higher returns. We may find that our allocation of 60:40 is appropriate right now between bond funds and alternatives investments but that might change if our models dictate that we do otherwise.

From time to time, we might consider cutting our exposure to the high yield bonds with the portfolio to 40% and use alternatives at 60%. In the alternatives, we may go heavily into a particular market that we think has the most potential. But we still guide our buy and sell decisions based on our technical analysis.

For instance, back in the end of the bull market in 2007 when the yield spreads on the high yields dropped from a recent low of 300 basis points to 2500 basis points in 2008, we changed our allocation to the high yields from the alternatives because we felt that we could make more money in that particular area. And then recently, when that scenario shifted, we changed our allocation to a little bit more toward the alternatives and little away from the high yield.

Although we do no want to take undue risks, we may be ready to invest if we see an opportunity that looks like the place to be for the next six months.

We use a modest amount of leverage from time to time so we can go up to 130% long by allocating 80% of the assets in the high yield bonds and a 50% to the alternative investments, always keeping in mind balancing higher returns with risk reduction techniques.

What we do on a daily basis is screen the whole universe of high yield funds to make our selection based on the best performing ones. We are likely to pick the ones that are performing as we generally like to ride the trend.

If they don't perform, we will not normally roll them out until we get our intermediate sell signal and the next time we get our buy signal we may select a different fund. Before we make our picks, we always bring them up all on one screen and do a comprehensive comparative review.

We are not bond analysts in terms of which bonds to pick, but we pick the bond funds that are likely to do better.

How is the high yield bond analysis different from your analysis?

Typically, the high yield portfolio is managed by an outside team who pick individual bonds. We do not pick individual bonds. We only research the relative performance of one bond fund over another.

We have our High Yield 15, the fifteen representative bond funds that we pool into a chart and make them into one fund of fifteen different bond funds. While we use that as our indicator we do not get skewed by one good or bad performance in making our decisions. When that indicator gives a buy signal, we start doing the individual selection process. If we want faster entries and exits, we use the high yield ETFs, which have no trading restrictions and are very liquid.

Do you pay attention to the macroeconomic view?

We do, but again, that does not have to do with the individual fund that we are picking. The overall macro view determines our allocation process.

For example, historically, high yield bonds that come out of a recession have good performance. In fact, coming out of the 2009 market rally, the high yield bonds rallied as much as stocks did but with much less risk.

At other times, like in 1998/99 during the Internet bubble, the high yield bonds did not do anything and the stock market was ripping. We would normally allocate less to the high yields and more to the alternatives that took those factors into the equation.

We look forward as to what kind of market are we in right now - is this is a bull market, bear market, sideways market, what is going on and what is the best place to be and just take our percentages and change them a little bit and skew them to where we think the better opportunities will be.

What is your asset allocation process?

Since we do not have a long term buy-and-hold strategy, we look at the market environment. We want to go where the action is but we do not want to take a lot of risk along the way.

We have limited our portfolio to a 10% or 15% long stock exposure at any one time in favorable situations. These are short term trading strategies because we are not buy-and-hold stock investors.

In the alternative strategy, we might take a basket of our favorite stocks. We may pick 25 stocks as a basket with a 10% position before we take a 10% position to short the S&P 500 index to hedge that whole position out.

While the market risk is minimal we think the stock picks will do better than the market itself.

What would cause you to hold cash?

If 60% of the portfolio is earmarked toward the high yield bond market while high yield bonds are in a bear market, we will be in a high cash position until that situation changes.

And, when we get back in, we have a good opportunity to make a lot more money in the high yield bond market because the yield spreads will eventually be beaten down to normal, which is almost 400 basis points higher than the U.S. Treasuries.

What are the main principles of your technical trading investing strategies?

If the high yield bond market is above the 50-day moving average, we will accept that as a bullish signal to us. It is a trend following device for high yield market and we tend to follow that.

When it comes to stocks, we trade a lot of different issues. We trade emerging market ETFs and look at the premium or discounts in that market. When our indicators show that it is oversold, we take a one-day trade on the emerging markets because there is an 80% probability that we are going to make money for a one-day-trade.

Additionally, we look at a universe of other people's funds that we chart to see how they respond in different market environments. Based on their relative performance, we may consider taking a position in them. If we do and they keep going up, we will stick with them. However, if they do not go up and we find something more attractive in the meantime, we may rotate out of those positions.

How do you choose the best five or six trends?

The core of what we do is a high yield bond trading strategy, which we have been utilizing for over twenty years. Throughout that period it has been generating on average 12% a year.

By using that model as our core position in the fund, and if the high yield bond market is not responding, we have the flexibility of moving with what we think could be the next opportunity. We diversify into some other areas that can enhance our returns without taking any more risk. Furthermore, if they can contribute in such a way when the high yields are not moving, we can still make some money.

Moving on to portfolio construction, how many holdings do you generally have?

Because we are trading strategies driven and very opportunistic in our approach, we can go 100% cash or have as many as ten funds that support our beliefs in the various strategies in the market.

For example, on the high yield side, recently we had six different funds including a floating rate fund, a corporate high yield fund and some high yield ETFs and derivatives like CDSs. We also held 10% cash at the time.

Our holdings can range from cash to ETFs in the market neutral fund, to a merger fund, to an absolute return fund and an alternative long/short fund. We also take positions from time to into currencies, long/short stock positions and securities signaled by our models.

What kinds of risk do you consider and how do you measure each of them?

We consider drawdown or permanent loss of capital as the biggest risk and we are constantly mindful of that. As a risk-averse investor, we prefer to invest in funds of bonds and diversify our holdings across various funds and different strategies.

Also, we reduce risk by selling our positions quickly if they do not deliver returns or perform the way we think they should.

Although our holdings are generally not correlated to the markets, we are always mindful of the downside beta. And as I said earlier, if something fails to meet our expectations we will sell it and look for another opportunity that is likely to work better.

Overall, we consider the Select Alternative fund to have the personality of a low volatility hedge fund, with daily liquidity and transparency with a lower cost structure, and may be considered as a holding for any conservative investor.

Hundredfold Select Alternative Fund

Symbol	**SFHYX**
Website	www.hundredfoldselect.com
Inv. Advisor	Advisors Preferred, LLC
Telephone	866-842-4860
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