BEACON
CAPITAL MANAGEMENT℠
A Sammons Financial Company

PROTECTING FROM TAIL RISK

BEACON'S PHILOSOPHY ON TAIL RISK

KEY POINTS | STRATEGY

Beacon Capital Management works to minimize the impact tail risk can have on a portfolio's long-term performance. By limiting losses of tail risk proportions, the recovery time from a market drop can be substantially reduced, thus increasing the longevity of assets within the portfolio.

Understanding Tail Risk

Investors understand they will be exposed to a certain degree of volatility when investing in the stock market. However, tail risk is a form of portfolio risk that occurs when the market experiences extreme volatility, equating to more than 20 percent swings in market performance. While tail risk statistically isn't supposed to happen often, it has occurred twice since 2000.

Losses are More Powerful than Gains

If a portfolio drops by 20 percent, the investments would need a 25 percent return to fully recover to the pre-crash balance. A 30 percent loss would require a 43 percent return, and a 40 percent loss, as some investors experienced in 2008, would require a 67 percent return to break even. However, if losses are minimized and the full market decline avoided, the amount of time needed to return to even can be dramatically reduced.

DISTRIBUTION OF YEARLY S&P 500 RETURNS (1926-2014)

Tail Risk

<-30%	-30 to -20%	-20 to -10%	-10 to 0%	0 to 10%	10 to 20%	20 to 30%	30 to 40%	40 to 50%	>50%
					2014				
					2012				
					2010				
					2006				
					2004				
					1993	2009	2013		
			2000	2011	1988	2003	1997		
			1990	2007	1986	1999	1995		
			1981	2005	1979	1998	1991		
			1977	1994	1972	1996	1989		
			1969	1992	1971	1983	1985		
			1962	1987	1968	1982	1980		
			1953	1984	1965	1976	1975		
			1946	1978	1964	1967	1955		
		2001	1940	1970	1959	1963	1950		
		1973	1939	1960	1952	1961	1945		
2008	2002	1966	1934	1956	1949	1951	1938	1958	
1937	1930	1957	1932	1948	1944	1943	1936	1935	1954
1931	1974	1941	1929	1947	1926	1942	1927	1928	1933

Source: Standard & Poor's

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LONG-TERM OUTLOOK

Consider a couple in retirement who wants to withdraw 5 percent of their account value each year for income, increasing each withdrawal by 4 percent annually to keep up with inflation. Their goal is to turn their portfolio into an income source for an anticipated 30-year retirement.

However, the market is unpredictable; consider the 30 years between 1926 and 1956, as the economy experienced a significant variety of activity; a market crash, depression, war and a strong market surge.

Under this scenario, the retired couple would run out of money after 22 years of withdrawals. Their portfolio could not recover from the two tail-risk scenarios encountered during their retirement.

Adding Protection from Downside

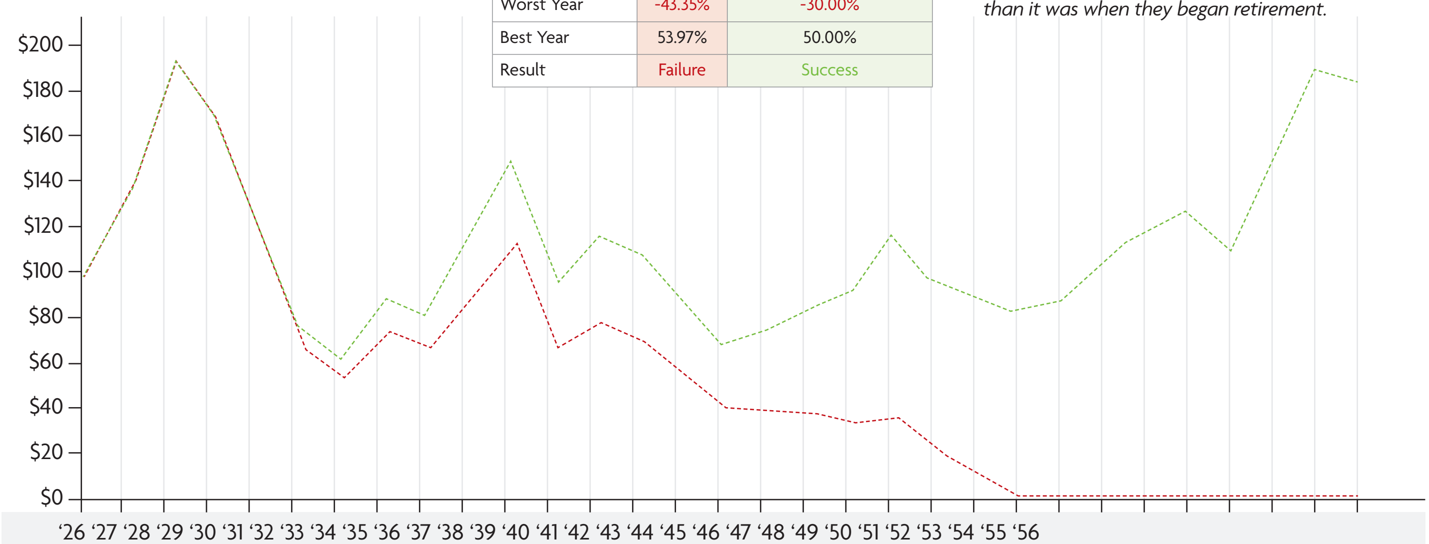
By attempting to control losses, we can work to maximize account value and extend the longevity of the assets for retirement. Consider this same retirement scenario had there been downside protection from the two most severe tail risk encounters. If we control the losses from exceeding 30 percent, we may not experience the full extent of a market rebound, so for this scenario, we will cap the largest gains at 50 percent as well.

S&P 500 INCOME GENERATION

(5% ANNUAL WITHDRAWLS INCREASED BY 4% EACH YEAR)

	S&P 500	S&P 500 Controlled Volatility
Return	10.05%	10.95%
Std. Deviation	25.31%	23.69%
Worst Year	-43.35%	-30.00%
Best Year	53.97%	50.00%
Result	Failure	Success

In making this adjustment to provide downside protection, the retired couple would not only have ***not*** *run out of money, but their account value would be greaterafter 30-years of withdrawals than it was when they began retirement.*



Source: Standard & Poor's. Illustration assumes reinvestment of dividends and capital gains.
Withdrawls are deducted annually at the end of each year.

By controlling tail risk, or the losses that can happen in the most extreme of market conditions, the performance outcome of the portfolio dramatically changes.