Portfolio Construction Ideas: Clients Love Commonsense Ideas **April 2023**
The ideal CORE is highly correlated to the CORE of the economy. Eric Clark

Key Points

- A 3-pronged approach via a CORE + SATELLITE portfolio is logical & effective.
- The CORE of a portfolio should be tethered to the core of the economy.
- The SATELLITE of the portfolio could be tethered to key mega trends (secular themes) and private markets, where better returns and smoother rides tend to happen.

The Core + Satellite Approach

In a bull market, generally every asset goes up and to the right. Some portfolios perform better than others but overall, everyone is making money and happy. Thankfully, markets go up roughly 80% of the time. I've been working with Advisors for 28 years now and have had the opportunity to analyze portfolio construction through the lens of a holdings-based approach. There is no right or wrong way to build a portfolio but today I wanted to highlight the potential benefits of a simple, 3-pronged approach driven by commonsense, logic, and robust data.

The classic portfolio definition of CORE: the largest and most important part of something.
The classic portfolio definition of SATELLITE: that which surrounds the core and adds value.

Remember, to oversimplify, this is generally what investors want when they make the decision to invest their capital for long-term growth:

1. Achieve attractive returns.
2. Have as smooth a ride along the way as possible.
3. Reach their target goal on time and intact.

How they accomplish these three goals is where the magic happens. In many cases, it's the BALANCE between the core and satellites that helps them accomplish their goals.

The CORE of the portfolio: tethered to the core of the economy.

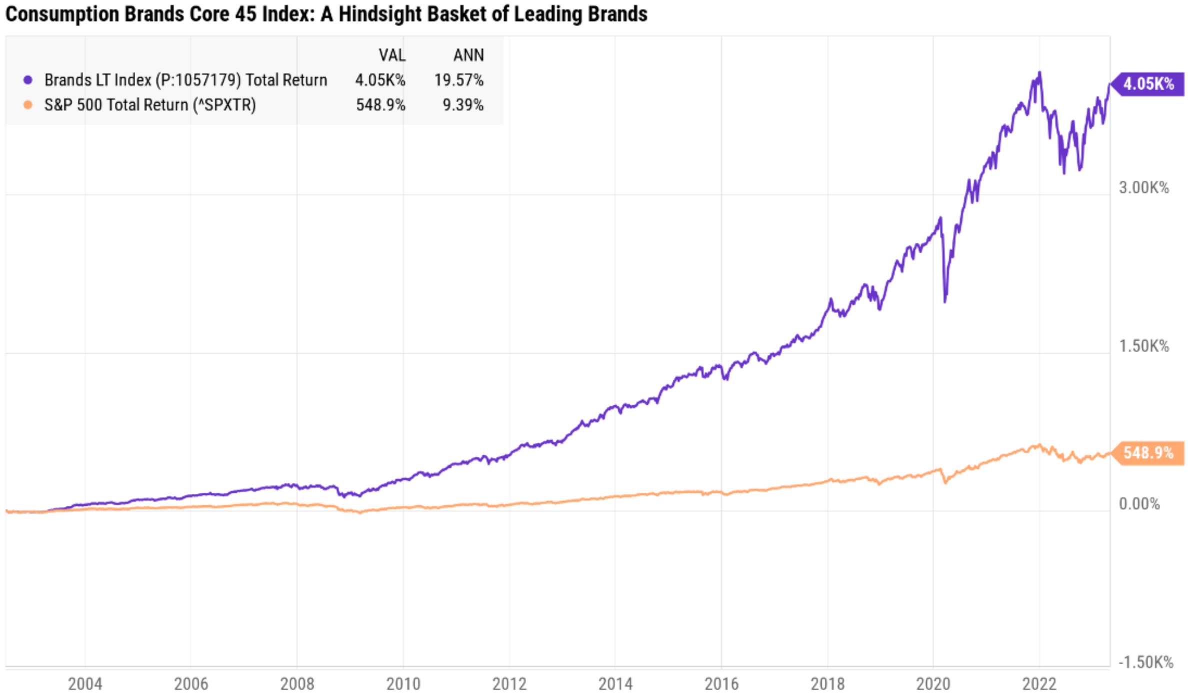
If given the option, I will bet 90%+ of HNW clients would prefer to own a portfolio they understand yet few clients could explain their portfolio construction to their neighbors or friends. At the core of Peter Lynch's portfolio philosophy was "invest in what you know." As consumers, investing in what we know tends to be easy because the answer lies within our spending DNA. We know roughly 70% of U.S. GDP is household consumption. We also know, roughly 60% of global GDP is consumption. So, there's this phenomenon called "consumption" that accounts for roughly $44 trillion each year, in good times and bad.

*If consumption is the core of every economy, by definition and logically, shouldn't **consumption stocks** be the core of our investment portfolios? Given the persistent home bias embedded in our portfolios, it seems odd to exclude the single largest driver of our country. Hard to dispute the concept yet in my experience, few have implemented the allocation with a weighting that is warranted for a proper "CORE".*

Consumption Stocks Have Performed Well & Added Strong Diversification Benefits.
Consumers all over the world make purchase decisions every day. At the center of these decisions is brand loyalty. Whether we realize it or not, we have a few brand favorites for every consumption category we participate in. For me, it's Nike in shoes, Apple for tech hardware, Amazon for e-commerce, Costco for general merchandise shopping, Lululemon for my wife, Blackstone for private markets investing, Lowes for home improvement merchandise, Visa & American Express for credit card use, and Hershey for sweet & salty snacks to name a few. Most brands have global reach, and the most relevant brands tend to have higher market share than peers. Logically, the most relevant brands serving the largest end-markets SHOULD be pretty good businesses which tends to make them pretty good stocks over time. Not every great brand is a great stock every year but, over time, the alpha tends to happen for top brands. Again, I don't think many people would dispute this premise. That's why we believe a Consumption Brands CORE is a timeless allocation so long as you constantly monitor brand relevance. Our team is relentless about analyzing brand relevancy.

The most important question for investors, have leading brands been worthy performers and worthy of being the CORE of a portfolio? To answer this, I built a 45 brand, hindsight basket of leading brands with long-term track records of staying relevant. The chart starts after the Netflix IPO, July 1, 2002, and runs to April 30, 2023. 20+ years of data in total.

Consumption Brands Core 45 Index: A Hindsight Basket of Leading Brands

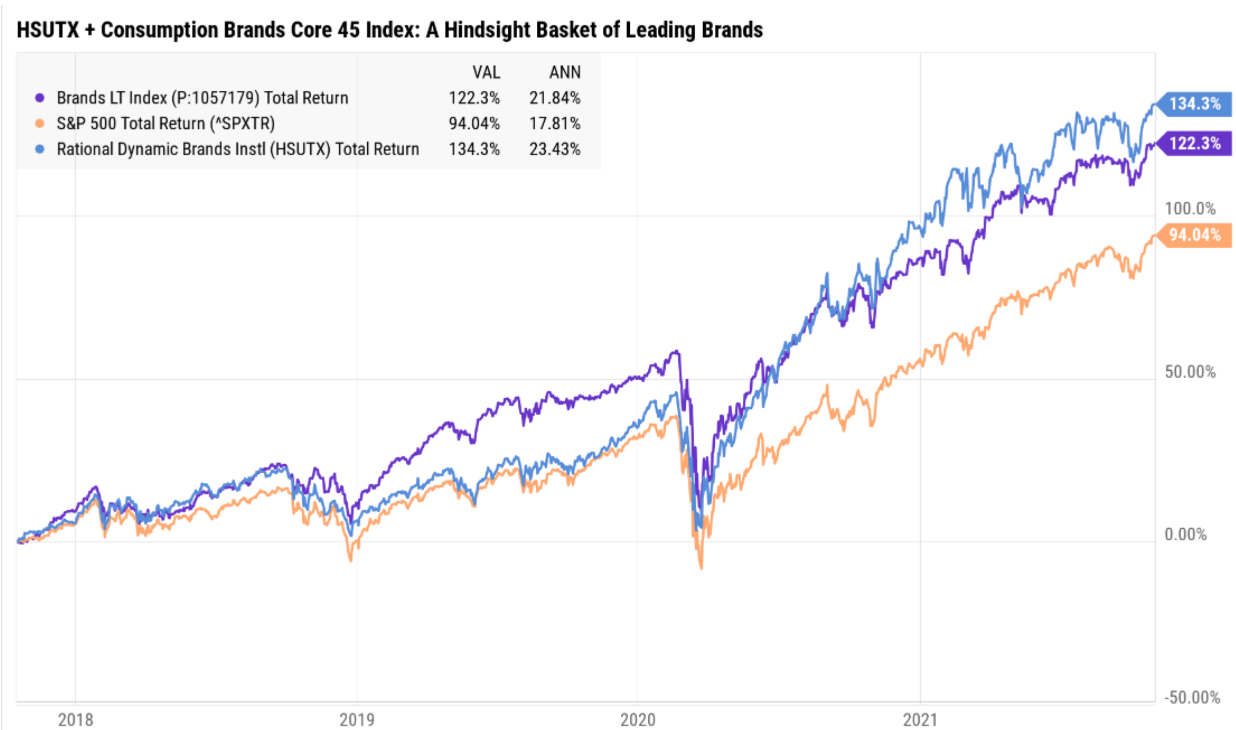


Data source: Ycharts.com.

Very important: the cumulative annualized returns of the top brands basket above do not matter. This is a hypothetical illustration of how powerful the theme of global consumerism is. A basket of leading consumption-economy brands serving global consumers and the consumption economy SHOULD, in theory perform well over time. That's indeed what this hindsight-created basket shows. Should we be surprised when consumerism is in our DNA?

How Did Dynamic Brands Perform in the Bull Market Period Since Inception?

Here's where it gets really interesting. Our team took over HSUTX on 10/17/2017. The bull market, particularly for high quality, growth-oriented stocks, peaked around November 1, 2021. Below, I compare the 45-stock hindsight portfolio, the Brands fund, and the S&P 500 over this 4-year time period. Again, the numbers do not matter in my opinion, it's the trend and the eerie similarity between the hindsight portfolio and the Brands Fund's actual experience.



Here's the leading brands that comprise the 45-stock, hindsight consumption portfolio: Amazon, American Express, Apple, Autozone, Best Buy, Booking Holdings, CarMax, Church & Dwight, Clorox, Coca-Cola, Colgate-Palmolive, Constellation Brands, Costco, Darden Restaurants, Decker's Outdoors, Dollar Tree, eBay, Garmin, General Mills, Johnson & Johnson, L'Oréal, Lennar, Lowe's, Marriot, McDonald's, Mondelez International, Monster Beverage, Nestle, Netflix, Nike, O'Reilly Automotive, Pepsi, Procter & Gamble, Ross Stores, Sherwin Williams, Starbucks, TJX Companies, Target, Estee Lauder, Hershey, Home Depot, Walt Disney, Tractor Supply, Walmart, and Yum Brands. Internally, we call this the Timeless 45.

Also important: Because I wanted to show a long-term time horizon, this analysis ignores some of the younger but highly relevant brands that have also been monster performers since going public. Brands like: Chipotle, Tesla, Lululemon, Crocs, Google, Meta (Facebook), Microsoft, LVMH, Hermes, Ferrari, Ulta Beauty, Etsy, and Domino's Pizza to name a few.
And this is just the Consumer Discretionary list, there's an additional list of "lifetime spending & investing" beneficiaries when you include sectors like healthcare, technology, & the alternative asset managers.

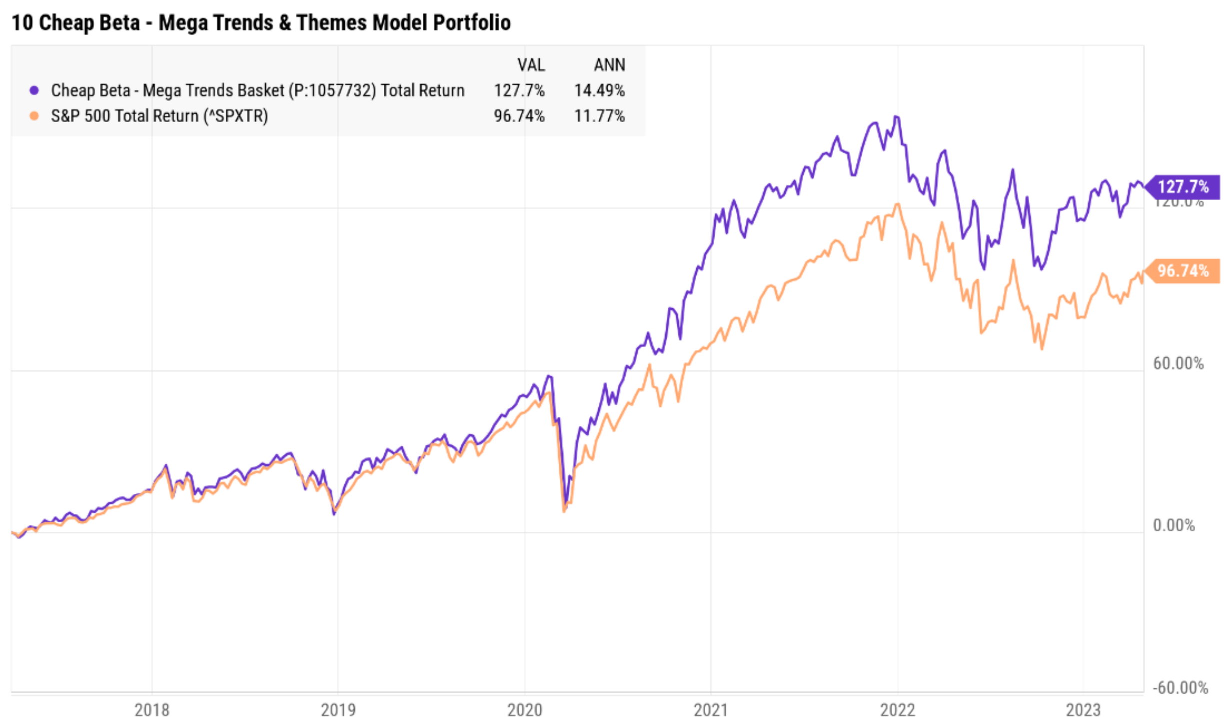
Yes, it would have been impossible to know that all the brands above would have been today's key brand leaders, but one could assume if a brand stayed relevant and operated in important consumption industries, the stock likely performed well over time. The irony, if I was tasked with creating a Timeless 45 portfolio a decade ago, most of the brands in the list of 45 would have been the same as those I used for today's analysis. When a brand reaches Mega-Brand status, it's typically due to a long period of time dominating a category. The point of this exercise, though, is to dedicate the core of the portfolio to a core group of leading companies serving the core driver of the economy. Constantly analyzing consumer trends and brand relevance clearly has incredible alpha-generating possibilities over time. And when the market acts irrationally and puts these businesses on sale, adding to them adds additional value because now you know how the movie ends. Even great businesses do not always perform well, that's impossible to ask of any company. In 2022, for example, Amazon was down 50% at the lows, and LVMH, Nike, Lululemon, Estee Lauder were down 40%+ while Meta and other top tech brands were down 60-75% as rates normalized. Many of these brands are up double digits or more YTD as of April 2023. There will always be demand for great businesses on sale so take advantage of these sales for you and clients.

Lastly, there's a clear benefit to pivoting to defensive, Consumer Staples when economic weakness is coming or simply holding them long-term, as the analysis shows. In bull markets the staples tend to lag but they also tend to play wicked catch-up when the growth brands are struggling. Consumer staples and other defensive sectors tend to be wonderful volatility dampeners so combining offense and defense in a portfolio can really help smooth the ride for investors.

The opportunity today: many of the world's most iconic and relevant brands are still well off their recent highs, even after a strong start to 2023. This is not surprising to us, nor are they deviating from history. Here's an analysis highlighting a broad-based basket of leading brands and their performance since being a public company, along with what the average forward performance was AFTER a drawdown year. Buy low, sell high seems to be a timeless approach. As you can tell, great businesses tended to recover nicely over the forward 3+ years after a drawdown so there's still plenty of time for your portfolios to benefit after a tough 2022.

Brand	All-time returns as of 12/31/2022	S&P 500 Return Same Period	2022 Return	Avg. Return in Negative Years	Number of Down Years Total	Fwd. Avg. Cal. Return Next 3 Cal. Yrs.
Amazon	85660%	638%	-49.60%	-32.9%	8	56.10%
Apple	40840%	2120%	-26.40%	-28.1%	15	48.20%
Google (Alphabet)	3420%	414%	-39.09%	-20.3%	4	36.17%
Estee Lauder	3650%%	978%	-32.32%	-22.1%	7	24.40%
Intuit	16080%	1400%	-39.11%	-36.0%	5	29.57%
Nike	21270%	2110%	-29.04%	-26.1%	9	32%
LVMH	2690%	534%	-10.87%	-16.0%	6	26.50%
Lululemon	2190%	241%	-18.16%	-27.40%	5	71.30%
Microsoft	94470%	2115%	-28.02%	-19.60%	9	30%
Domino's Pizza	5320%	399.70%	-37.88%	-35.0%	3	38%
Costco	6240%	2124%	-19.06%	-21.0%	8	13.50%
Target	5240%	2122%	-34.27%	-19.0%	15	26.00%
Williams-Sonoma	4680%	2110%	-30.48%	-27.9%	12	36.10%
TenCent Holdings China	3002%	436%	-25.31%	-20.0%	4	38.00%
Mercado Libre Latin America	2960%	258%	-37.24%	-25.0%	6	65%
Thermo Fisher	6650%	2110%	-17.30%	-22.50%	15	33.40%
Lowe's	30230%	2110%	-21.50%	-18.40%	15	18.70%
Accenture	1970%	498%	-34.70%	-16.50%	5	24.00%
Nvidia	38720%	380.60%	-50%	-39.70%	7	49.70%
Netflix	24550%	428.20%	-51%	-35.60%	5	68.70%

The SATELLITE allocations could be tied to key mega-trends happening around the world. This part of the portfolio and around the core consumption basket does not have to be complex but it is subjective and driven by client needs and risk tolerances. Satellite #1 could focus on a few important mega-trends that can be implemented through ETF's. Examples are: leaders of innovation (QQQ & SPY), semiconductors (SMH) being a part of everything, medical breakthroughs & life sciences (IHI, BBH, IHF), clean energy transition (ICLN), Infrastructure Spending (PAVE), and stable predictable dividend income (DGRW & SPHD). Here's how that basket performed over the last 6 years, between April 1, 2017 and April 30, 2023.



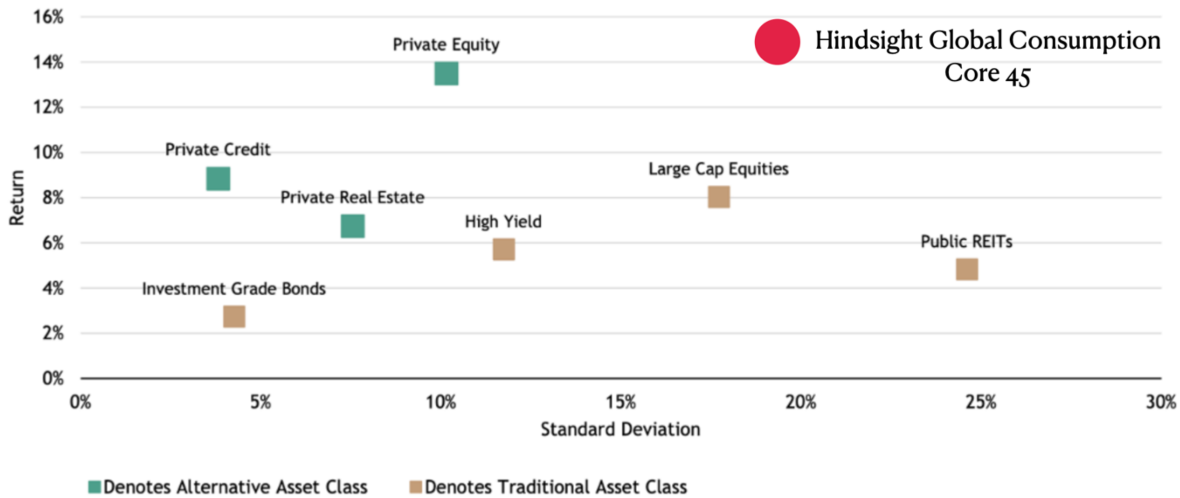
Satellite #2 focuses on the opportunities available in private markets. Why private markets you ask? Because the vast majority of companies operating today are private, not public. Virtually every investor is missing the allocation to the largest part of our economy. If you cannot or will not give up a little liquidity to own a basket of private market funds, I urge you to research the leading brands that are owners of many of these terrific private companies, over time their stocks should perform well as their investments get realized. A stat from Blackstone might help you understand why these asset managers have such exceptional performance: Blackstone owns 264 private companies that, in aggregate, employ over 700,000 people. Their systems aggregate company data to help them see current and future trends that allow them to generally see better around corners than most of us. When you see the future more clearly, you can allocate toward the beneficiaries well in advance of other market participants. Also, when you are a passive investor, you must hope the companies you invest in execute well over time. When you are a private owner of businesses, you can affect change because your hands are on the wheel with all the management teams. Having your hands on the wheel allows your success rates to be much higher than the buy, hold, and hope approach to being a passive public stock owner.

Here's how private assets have performed between 2007 and 2022. Just for fun, I added the hindsight-based, global consumption Core 45 Brands basket for the same time period. Yes, zero-interest rate policy had a positive effect on all asset classes, with Private Equity performing incredibly well. What naysayers will omit is the track record of private markets over multiple decades and through different interest rate regimes, which is also quite stellar. Picking the right firms and funds is key to success in the private markets.

Private markets have outperformed most public asset classes on a risk-adjusted basis over the long run

Risk-Return

(2007-2022)(1)



Note: **Past performance is not necessarily indicative of future results.** There can be no assurance any alternative asset classes will achieve their objectives or avoid significant losses. These indices have been selected as generally well-known and widely recognized indices and not as a benchmark for any specific fund. Equity indices include reinvestment of dividends. A summary of the investment guidelines for the indices is available upon request.

(1) Source: Morningstar, over the 15-year period from 10/1/2007 to 9/30/2022. The returns and volatility of the asset classes presented are based on the following indices: Private Equity: Cambridge Associates U.S. Private Equity. Public REITs: MSCI US REIT Index. Investment Grade Bonds: Bloomberg US Aggregate Bond Index. Private Real Estate: NFI-ODCE Index. High Yield Bonds: Bloomberg US Corporate High Yield Bond Index. Large Cap Equities: S&P 500 Index. Private Credit: Cliffwater Direct Lending Index.

Bottom line:

A 3-pronged investment portfolio that consists of a global consumption core, cheap beta mega-trends satellite #1 and private markets basket satellite #2 would have generated very robust returns over a long period of time. From a pure logic and client understanding perspective, it's likely a portfolio people will be excited about and one they can easily talk to their friends about. Now, you have a book of engaged clients that can be harnessed to become the best marketing machine a team could ever want.

The pitch is simple: The consumption theme never changes, making global brands a great core anchor in a portfolio. The cheap beta allocation allows people to invest in important mega-trends and themes and should be expected to change over time according to where we are in the business cycle. The private market allocations help shield investors from some of the day-to-day public market volatility while giving them access to many of the smartest investors in the world. The allocations to all three components can be customized according to each client, but the benefits remain very well chronicled. Princeton's +13.7% annualized return (the S&P 500 average was ~9%) holding >50% privates tell a very powerful story!

There are some wonderful companies still on sale today, perhaps now is a good time to shift some assets to these 3 thematics.

Disclosure:

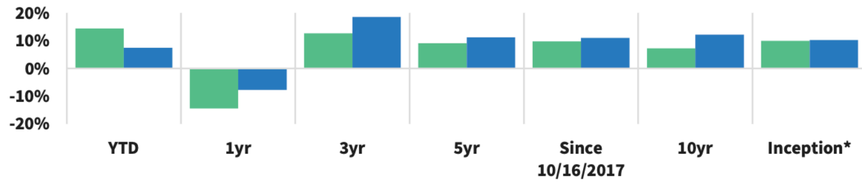
The above report is a hypothetical illustration of the benefits of using a 3-pronged approach to portfolio management. The data is for illustrative purposes only and hindsight is a key driver of the analysis. The illustration is simply meant to highlight the potential value of building a consumption focused core portfolio using leading companies (brands) as the proxy investment for the consumption theme. This information was produced by Accuvest and the opinions expressed are those of the author as of the date of writing and are subject to change. Any research is based on the author's proprietary research and analysis of global markets and investing. The information and/or analysis presented have been compiled or arrived at from sources believed to be reliable, however the author does not make any representation as their accuracy or completeness and does not accept liability for any loss arising from the use hereof. Some internally generated information may be considered theoretical in nature and is subject to inherent limitations associated therein. There are no material changes to the conditions, objectives or investment strategies of the model portfolios for the period portrayed. Any sectors or allocations referenced may or may not be represented in portfolios managed by the author, and do not represent all of the securities purchased, sold or recommended for client accounts. The reader should not assume that any investments in sectors and markets identified or described were or will be profitable. Investing entails risks, including possible loss of principal. The use of tools cannot guarantee performance. The charts depicted within this presentation are for illustrative purposes only and are not indicative of future performance. Past performance is no guarantee of future results.

A Core Equity Strategy Investing in the $44 Trillion Household Consumption Theme

ACTIVE MANAGER

Performance (%): Ending March 31, 2023[1]

Annualized if greater than a year



Previous Strategy

Share Class/Benchmark	YTD	1 Year	3 Years	5 Years	Since 10/16/17[1]	10 Years	Since Inception*
Class I	**14.43**	**-14.37**	**12.70**	**9.14**	**9.80**	**7.31**	**10.00**
S&P 500 TR Index	7.50	-7.73	18.60	11.19	11.04	12.24	10.29
Class A	**14.35**	**-14.60**	**12.38**	**8.86**	**9.51**	**7.03**	**9.72**
Class A w/ Sales Charge	**8.90**	**-18.65**	**10.57**	**7.81**	**8.53**	**6.51**	**9.46**

*Inception: 09/27/2002

The maximum sales charge for Class "A" Shares is 4.75%. In the case of investments of $1 million or more (where you do not pay an initial sales charge), a 1.00% contingent deferred sales charge (CDSC) may be assessed on shares redeemed within two years of purchase. Performance is historic and does not guarantee future results. Investment return and principal value will fluctuate with changing market conditions so that when redeemed, shares may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. To obtain the most recent month end performance information or the funds prospectus please call 800-253-0412 or visit www.rationalmf.com.

[2]The Alpha Brands Consumer Spending Index: The "Index" tracks the performance of 200 highly recognizable and relevant U.S. and foreign brands with a business to consumer and business to business focus.

Past performance is not a guarantee of future results.

Investors should carefully consider the investment objectives, risks, charges and expenses of the Rational Funds. This and other important information about the Fund is contained in the prospectus, which can be obtained by calling (800) 253-0412 or at www.rationalmf.com. The prospectus should be read carefully before investing. The Rational Funds are distributed by Northern Lights Distributors, LLC member FINRA/SIPC. Rational Advisors, Inc. is not affiliated with Northern Lights Distributors, LLC.

Risk Considerations:

Investing in the Fund carries certain risks. The value of the Fund may decrease in response to the activities and financial prospects of an individual security in the Fund's portfolio. These factors may affect the value of your investment. Investments in international markets present special risks including currency fluctuation, the potential for diplomatic and political instability, regulatory and liquidity risks, foreign taxations and differences in auditing and other financial standards. Risks of foreign investing are generally intensified for investment in emerging markets. Emerging market securities tend to be more volatile and less liquid than securities traded in developed countries.

Investors Choice Awards Methodology - All funds reporting to Allocator.com are considered for the awards. The Top Performer Awards - these are granted to the select few funds which have outperformed their wider peer group in each category. Winners are determined purely based on quantitative risk-adjusted returns. The 2021 Top Performer award winners will be chosen based on absolute returns from January 1, 2020 to December 31, 2020. The Long Term categories consider returns from January 2018 to December 2020.

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