Volatility Reduction in Focus:
The Case for the Sentry Hedged Growth Strategy

SENTRY
CAPITAL MANAGEMENT

Introduction:

For most investors, it's not just the destination that matters …but the journey. Equities are essential for growth, but the sharp, periodic losses that inevitably come with the asset class can have severe consequences for clients at any stage of the investment continuum. For these reasons, investors need strategies that offer equity market participation, but whose value-add centers on volatility reduction.

The following primer explores the philosophy and approach underpinning the Sentry Hedged Growth Strategy ("Sentry HG"), a strategy that uses passive ETFs to achieve market-like returns and relies on liquid options – without leverage – to limit downside capture. By taking a less complicated approach to equity market participation and options markets, we believe the strategy can serve as an essential component of most investor portfolios.

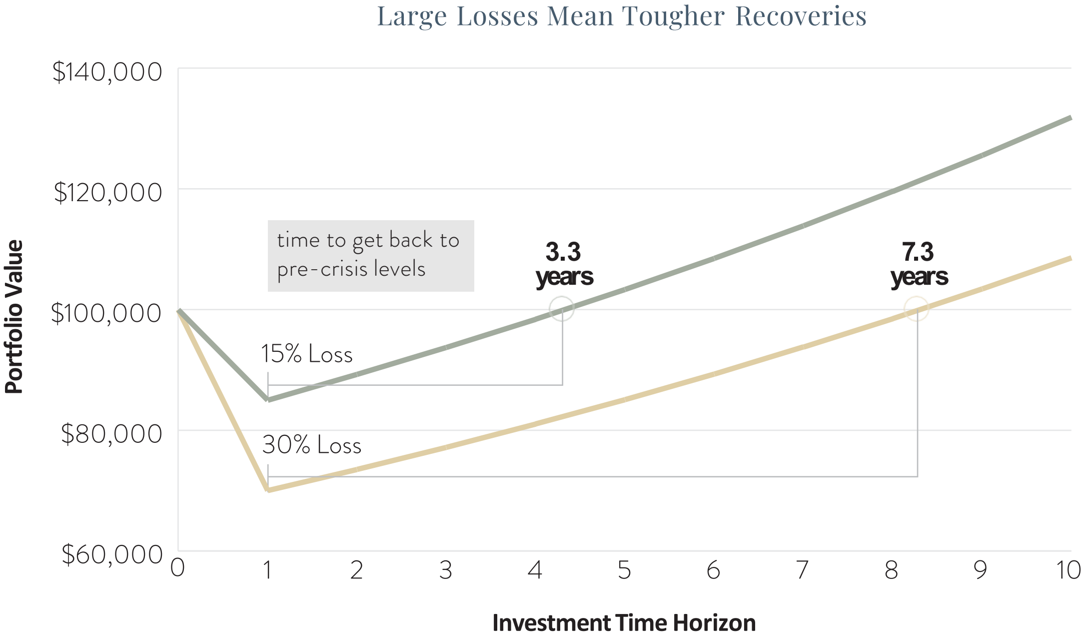
I. Volatility Reduction: The Key to Meeting Long-term Investment Objectives

An 11-year bull market made it easy to forget, but early 2020 and early 2022 served a reminder that volatility, can – and does – strike at any time. By dampening drawdowns in those painful periods, a portfolio has a smaller hole to climb out of after an equity market downturn, helping that strategy outperform broader equity markets over full market cycles.

Volatility reduction has other, more profound implications for helping investors achieve their long-term objectives. For investors with long- to mid-range time horizons, reducing the volatile swings in equity markets can keep them off the sidelines, remaining fully invested through a downturn, so they get the full benefit of compounding over a lifetime of equity investing. Meanwhile, investors at or near retirement can ill-afford to suffer a significant drawdown to their nest egg right when they need to draw from it.

Large drawdowns have long-term consequences. Limiting a big loss can dramatically speed up the time it takes to bring the portfolio back to its original, pre-crisis level, and can lead to significantly better results over a longer time horizon.

Portfolio Value: $100,000
Growth Rate: 5%



For these reasons, covered call strategies that achieve equity-like returns with less volatility can be a valuable complement to any investor's portfolio. But investors must be mindful of how the strategy achieves equity-like returns and how it uses options to manage volatility. We explore those topics in the next two sections.

II. Equity Exposure: Inexpensive and Holistic

The most vital aspect of a covered call strategy is how it dampens volatility using options while maintaining equity market exposure. The Sentry HG objective is to obtain broad equity exposure as economically efficient as possible.

To achieve greater market breadth, the fund invests in passive ETFs replicating the S&P 500, the NASDAQ and the Russell 2000 indices. By selecting these three indices' investors get exposure to large and small-cap markets, and the growth of the technology sector. Its objective is not to add value by making over- or under-weight allocations to a given index, but instead ensuring clients maintain the broadest exposure possible.

III.The Options Overlay: A Responsible Approach to Dampening Volatility

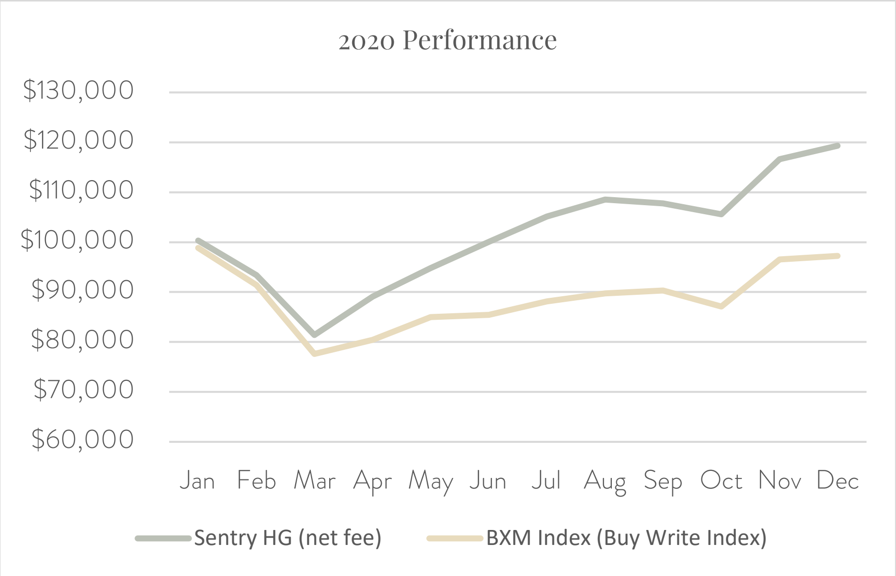
ETFs allow investors to participate in equity markets' long-term upside potential cost effectively and efficiently. But dampening the volatility inherent in achieving those long-term returns cannot be realized as effectively with a mechanical, passive approach. Sentry provides its value by solving this problem. The strategy relies on ETFs for equity market participation, but actively manages options to achieve two outcomes:

- **Offset losses in down markets.**
- **Provide additional yield in flat markets.**

Achieving those outcomes is limited with a passive approach. Options markets provide a wide range of potential opportunities for portfolio managers based on the option's strike price and expiration. Active options managers can also capitalize on volatility in options markets to select the best position that provides the best potential yield or hedge.

Passive approaches such as the Cboe S&P 500 BuyWrite Index (Sentry HG benchmark) are hamstrung from capitalizing on these opportunities. The mechanical nature of such strategies dictates that they consistently sell the closest strike price to the value of the S&P 500 Index on a pre-determined time and date. They lack the flexibility and nimbleness to find the best opportunity option markets present. As the charts below show, the missed opportunities can be considerable, particularly in flat and down markets.

The first chart shows the performance of both the strategy and its benchmark in 2020, a period that includes the most significant market drawdown in more than a decade. Sentry's ability to actively use options to limit losses helped it outperform when markets were down, leading to outperformance for the year-to- date period. The second table shows how actively managing the options portfolio has contributed to outperformance – and lower standard deviation – since the Strategy's inception. In short, actively managing the options overlay has provided a considerable advantage relative to a passive covered call approach.



	Sentry HG (net)	BXM Index
Annualized Return	8.9%	6.3%
Standard Deviation	11.7%	9.5%
Sharpe Ratio	0.65	0.52
Risk-Adjusted Return	7.8%	5.6%

* Results are annualized from 01/2013 thru 05/2023.

Risk Controls for Options Investing

The Sentry Hedged Growth Strategy takes a back-to-basics approach to options trading, using the instruments for one of their most intended solutions: PROTECTION.

Options trading draws negative connotations with some investors, due to the speculative nature in which some hedge funds use them. These funds will employ leverage to take on speculative bets in options markets, a risky endeavor that has sometimes backfired.

This is not the intent of the Sentry Hedged Growth Strategy. The strategy does not employ leverage or use options trading to make a speculative bet, rather, the portfolio holds the required number of underlying ETF shares to cover each option it writes.

The strategy takes a few other measures to reduce risk within the options overlay:

First, the portfolio owns options against broad-based index ETF's (Exchange Traded Funds), which are some of the most liquid options markets in the world. This approach is different from other options strategies, which may use options for specific stocks or sectors. The latter approach has a higher risk element and can be more volatile.

Second, the strategy only sells options expiring within the next three months, avoiding longer-duration trades to maintain flexibility.

Finally, positions are actively monitored daily to continually manage risk. The lack of leverage and other controls ensure the options overlay is carrying out its original intent: enhancing yield and reducing risk.

IV. Conclusion:

Equity market participation is essential for the goals of nearly every investor. Passive investment structures allow for that participation inexpensively and efficiently. The key for advisors and allocators is to help dampen volatility so that clients stay invested through the market cycle.

Sentry's Hedged Growth Strategy takes advantage of passive equity market participation but use options – without leverage – to minimize the volatility that is inevitable through an entire equity market cycle.

Importantly, managing volatility requires an active approach. By actively monitoring the opportunity set among different strike prices and expirations dates – and capitalizing on volatility within options markets – a portfolio manager can produce better outcomes that go further in dampening volatility than a mechanical, covered call writing approach. The dampened volatility creates better long-term results for investors.

To find out more about Sentry Capital Management:

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