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September 16, 2014

Elizabeth M. Murphy, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: **SR-NYSEArca-2014-30**

Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change Relating to the Listing and Trading of Shares of Hull Tactical US ETF under NYSE Arca Equities Rule 8.600

Dear Ms. Murphy:

In his review article "New Facts in Finance," John Cochrane wrote:

> *Researchers once believed that stock returns (more precisely, the excess returns on stocks over short-term interest rates) were completely unpredictable. It now turns out that average returns on the market and individual securities* do *vary over time and that stock returns* are *predictable.*

I believe that this accurately summarizes a true paradigm shift in how finance academics think about asset returns. The random walk model has been tossed out the window. Instead, we find that returns on all asset classes display numerous patterns of predictability, and many variables appear to predict future stock returns in particular. Some of those variables are based on financial data (e.g., interest rate spreads) while others come from the real economy (e.g., new orders). There is a tendency for variables that are countercyclical to be positively related to future returns.

The implication of all this is that maintaining constant exposures to different asset classes is suboptimal. We can reap greater long-term rewards, without increasing risk, by increasing our exposure to an asset class when its future returns are predicted to be above average. We trim or even short an asset class when its future returns are predicted to be poor. There is strong evidence from the finance literature that these so-called *tactical asset allocation* (TAA) strategies work out of sample and that they have significant value to the investor who uses them.

In my own view, retail investors already engage heavily in tactical asset allocation. Specifically, they increase their exposure to stocks after a bull run and sell stocks in the middle of a crisis or panic. This behavior is well documented. Unfortunately, it is exactly the opposite of what those investors should be doing, and the losses that they suffer from this systematic misunderstanding of return predictability can be catastrophic.

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Not only is this behavior suboptimal for the investor, it is destabilizing to the market, as the investor's buys or sells have the effect of pushing the market further towards the extreme to which it was already moving. Done correctly, however, tactical asset allocation will have stabilizing effects, as investor buys and sells will instead be moving against the prevailing direction of the market. Thus, there is a good reason to encourage TAA strategies beyond the fact that they are good for the investors that follow them.

There is nothing inherently risky about tactical asset allocation, especially for strategies limited to holding cash and a market index. In the long run, the risk of this type of strategy will mostly be determined by the average exposure that the fund takes relative to the market. For a fund with a stock market weight that is constrained to lie between -1 and 2, as is the case with Hull Tactical US ETF (Ticker Symbol: HTUS), a reasonable expectation is that the average exposure, or beta, would be somewhere around 0.5, the midpoint of that range. The managers of the fund have allowed me to see the equity exposures that have arisen from their model since 2001. The actual average exposure in fact turns out to be almost exactly 0.5. This fund should be noticeably less risky than a standard equity index fund. Furthermore, the type of model that the fund's managers use to derive these exposures on is standard, and I would not expect the average exposure in the future to be much different.

To sum up, TAA strategies are beneficial to investors and may have positive effects on market stability. In my view, tactical asset allocation strategies should be encouraged both by investment advisors and regulators.

Sincerely,

Christopher S. Jones

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