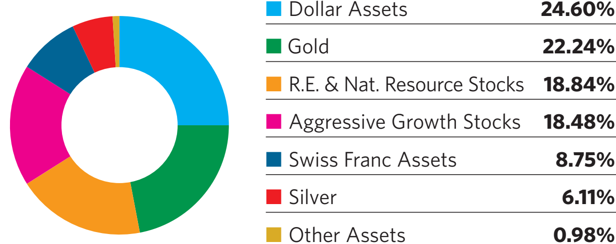
FINANCIAL ADVISOR
FA
PORTFOLIO SPOTLIGHT

Michael J. Cuggino

The Permanent Portfolio Fund

TICKER	PRPFX
ASSETS	$3 billion
PERFORMANCE	YTD **10.94%** · 1 yr. **9.10%** · 3 yr. **1.06%** · 5 yr. **0.87%** · 10 yr. **4.72%**
TOP FIVE HOLDINGS	Gold coins, gold bullion, silver bullion, two separate U.S. Treasury bond issues
CONTACT INFO	866-792-6547 permanentportfoliofunds.com

As of 11/30/2016. Three, five, and 10-year returns are annualized.
Source: Morningstar



As of 9/30/2016. Source: Permanent Portfolio Funds

Keeping The Faith

This inflation- and volatility-fighting fund has been faithful to its model through trying times—and surged in 2016. **By Marla Brill**

IT'S HARD TO FIND AN INVESTMENT THAT HAS STUCK TO its knitting as faithfully as the Permanent Portfolio Fund. Since its launch in 1982 it has invested in a consistent mix of non-correlated asset classes including U.S. Treasurys, stocks, precious metals and Swiss government bonds, regardless of market conditions or sentiment. Its managers have used the same asset allocation model as a blueprint for nearly 35 years, with a goal of fighting inflation and providing low-volatility ballast to portfolios driven largely by stock market returns.

"Whether it's surprise election results or football games, people have trouble predicting the future with any consistency," says Michael J. Cuggino, who has managed the fund since 2003. "Permanent Portfolio is designed to avoid human failures of prediction through a consistent, diversified process."

The fund has succeeded in its mission to beat inflation over the long term. As of September 30, it had an annualized five-year return of 2.60%, while its inflation bogey, the Citigroup 3-Month Treasury Bill Index, saw 0.08%. Over 10 years it returned 5.67%, while the index returned 0.84%. The S&P 500 index had higher five-year annualized returns of 16.37% and 10-year returns of 7.24%, but it had much greater volatility.

The atypical structure of the portfolio eludes easy categorization. Cuggino says some investors think of it as a core holding, and use specialized investments around it. Others put it in their alternative basket, or view it as more of a fixed-income investment because of its low volatility. "People should think of us as a low volatility anchor product," he says. "It's kind of a hedging strategy, only a lot cheaper than most." (The fund's expense ratio for Class I shares is 0.80%.)

Over the years, the fund has moved in and out of fashion as the economy and markets have shifted gears. During the 1980s, its defensive posture and low volatility offered a shelter in the storm of stock market chaos and persistent inflation that pre-

PHOTOGRAPHY BY CHRISTINA STETSON

Cuggino sees the allocation as an insurance policy to anchor more traditional stock and bond assets and as a way to provide inflation protection.

vailed at the time. But during the bull market of the 1990s, its heavy presence in hard assets and commodity stocks seemed as outdated as the long lines at the gas pump and soaring interest rates that helped inspire its creation.

Times of crisis have brought out its best colors. In 2008, it was down just 8.36% while its Morningstar target risk category lost 18.61% and the S&P 500 lost 37%. During the credit crisis that spanned August 2007 to September 2009, a $10,000 investment in the fund would have grown to $11,403, while an investment in the S&P 500 would have dropped to $7,648. In the dot-com bust from April 2000 until March 2003, an investor in the fund would have made $2,110, while an index investor would have lost more than $4,000.

Between 2008 and 2012, the fund's strong performance in difficult markets attracted hordes of investors, and by the end of 2012 its assets had ballooned to more than $17 billion. But the wind shifted in 2013, when a correction in precious metals and commodity prices, along with stalling bond prices, led to a drop of 2.02%, followed by a return of negative 0.82% in 2014 and negative 6.58% in 2015. With the bull market in stocks magnifying the disappointing three-year performance, investors abandoned the fund in droves, and by the end of 2013 Permanent Portfolio had shed half its assets.

Short-term thinking and performance chasing no doubt hastened the bloodletting. "We were down around 9% over a three-year period, yet we lost over 80% of our assets," recalls the 53-year-old Cuggino. "During the peak years, I warned people not to get used to the kinds of numbers the fund was generating."

In 2012, he says, one investor asked him why the fund's return was so much lower than that of the S&P 500 that year. To him, it sounded like a warning that perhaps a lot of shareholders didn't really understand the fund and its purpose in investors' portfolios. "We weren't doing anything other than what we had always done, but investor expectations just got way ahead of what we are about. There are periods when the fund doesn't do much, and that makes people frustrated. We will never outperform equities in strong bull markets. But over the long term, the fund has done its job."

A Turning Tide?

The tide appeared to turn in 2016 when the fund rose 14% during the first nine months of the year, when the S&P 500 rose only 8%. Cuggino attributes the solid performance to the fund's strength in market environments where there is mixed performance in various asset classes rather than in bull markets of just stocks or bonds.

Both of those asset types, he says, are very richly priced. In the stock market, earnings growth has slowed for most U.S. companies, and it remains to be seen whether it will pick up again. And interest rates are so low that bonds have more room on the downside than the upside.

He notes that some parts of the portfolio could benefit from rising rates because such an increase signals an economic expansion, which often bodes well for gold and commodity prices. And the trough for commodities could bottom out if demand for energy and industrial commodities accelerates.

The prospect for rising rates and economic growth came into clearer focus soon after the U.S. presidential election as Treasury yields rose and the possibility of an expansive new fiscal policy rekindled inflation expectations. There's also the question of who will replace Fed Chair Janet Yellen when her term expires in February 2018. Given Trump's harsh criticism of Fed policy during her tenure, he might appoint someone who is more likely to raise interest rates.

Target Portfolio Structure
(As a % of portfolio)

Dollar Assets	35%
Gold	20%
R.E. & Nat. Resource Stocks	15%
Aggressive Growth Stocks	15%
Swiss Franc Assets	10%
Silver	5%

Source: Permanent Portfolio Funds

Fixed Income and Currency
(As a % of portfolio)

U.S. Treasury Securities	15.04%
Corporate Bonds	9.56%
Cash & Other	0.98%
Swiss Franc Assets	8.75%

As of 9/30/16. Source: Permanent Portfolio Funds

Top 12 Equity Holdings
(By Sector)

Natural Resources
Freeport-McMoRan, BHP Billiton Ltd., Chevron

Real Estate
Digital Realty Trust, Prologis, Essex Property Trust

Growth
Facebook, Janus Capital Group, Lockheed Martin

As of 9/30/16. Source: Permanent Portfolio Funds

Characteristics

Turnover	5.92%
Alpha	2.85
Beta	0.30
Correlation	0.55
Standard Deviation	8.14

Benchmark for statistics is S&P 500 Index from January 1, 1983 through September 30, 2016.
Source: Permanent Portfolio Funds

Fees and Expenses
(Class I Shares)

Sales Charge	None
Annual Fund Operating Exp.	0.80%
Minimum Investment	$1,000

Source: Permanent Portfolio Funds

No matter what happens with a new administration, interest rates or the stock market, the fund will no doubt bypass all of it by hewing to its target allocations. Twenty percent of its assets are earmarked for gold, and another 5% is in silver. Cuggino sees the allocation as an insurance policy to anchor more traditional stock and bond assets and as a way to provide inflation protection. The fund holds both metals physically in bullion and coins rather than in ETFs, even though a number of ETFs closely track their prices. "We're institutional investors, so we don't need to have a middleman of an ETF involved," he explains.

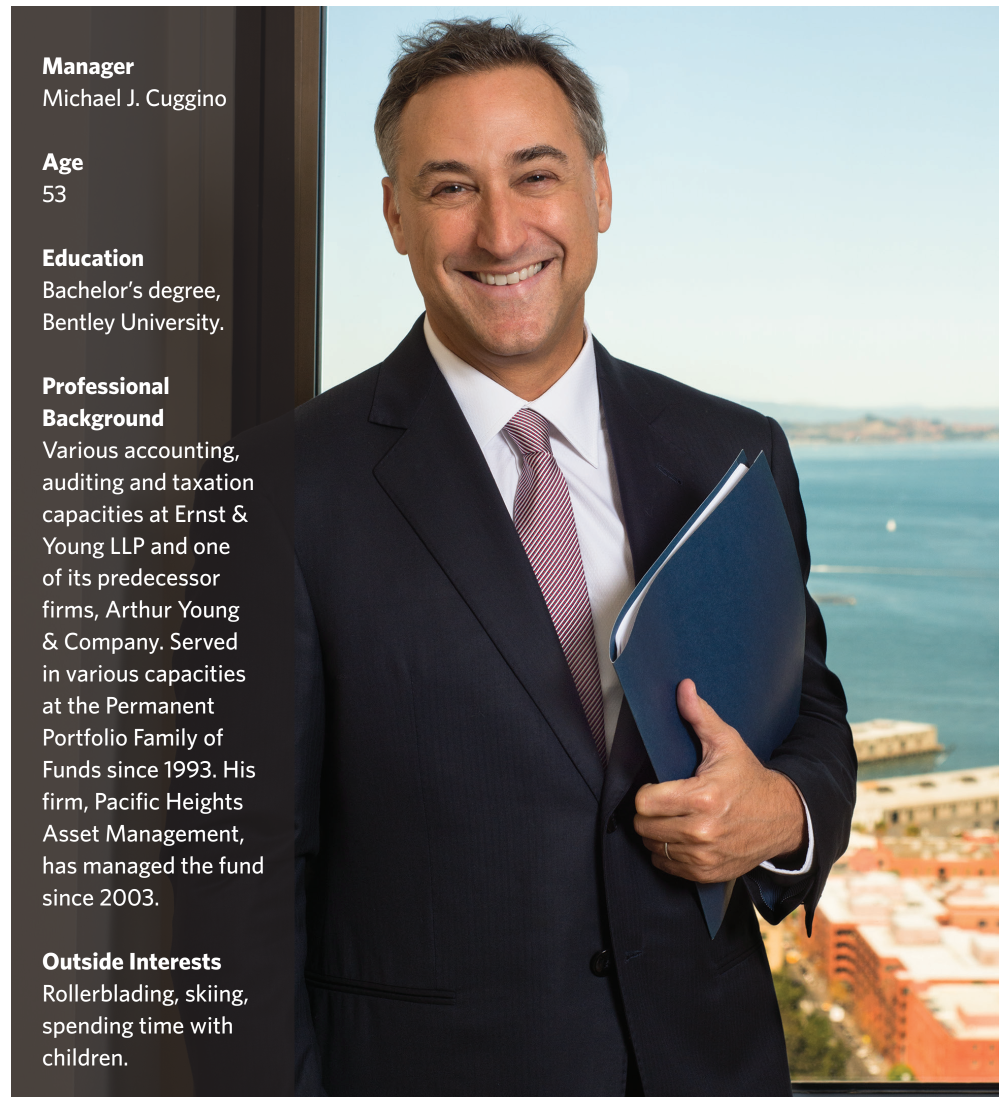
Another 10% is earmarked toward Swiss franc assets, including demand deposits of Swiss francs at Swiss and non-Swiss banks, as well as highly rated bonds and other securities issued by the Swiss government. This part of the portfolio serves as an offsetting hedge against a decline in the U.S. dollar and provides a balance against dollar-denominated assets. While the dollar, euro and many other global currencies are subject to political and devaluation pressures, he says, the Swiss franc is less susceptible to such manipulation and the Swiss National Bank has a history of protecting its value.

Fifteen percent of the fund goes toward U.S. and foreign real estate and natural resource stocks. The group includes real estate investment trusts (REITs), as well as companies involved in the mining and exploration of natural resources and metals. Fifteen percent is in aggressive growth stocks, and 35% is targeted toward U.S. Treasury securities and high-quality bonds of flexibly managed duration. The latter group provides protection during periods of recession or deflation, when bond prices tend to go up and yields fall.

Because investment prices are constantly changing, the portfolio's holdings may not match exactly the target percentages. When the deviation exceeds more than one-quarter of the target percentage, the fund will buy or sell investments to correct the discrepancy within 90 days unless changing market prices bring allocations back in line with targets. The bond portion of the portfolio has strayed furthest from its target lately, accounting for 25% of assets as of September 30, while its target is 35%. Cuggino made the decision to underweight because of his concerns about rich fixed-income valuations and rising interest rates. Those concerns also led him to trim the duration of the bond portion of the portfolio, which consists of Treasury securities and short-term investment-grade corporate bonds, to about four years.

Cuggino won't predict whether the economic and market uncertainty that has historically helped his fund look better than the competition will return in 2017 and beyond. But he observes that investors concerned about the aging bull market in stocks and bonds appear to be more open to multi-class investing than they were a few years ago. Some former investors in the fund have already come back, and he anticipates word about it will spread to new ones.

"The market seems to be cycling back to an environment more conducive to multi-class investing," he says. "I think investors are starting to recognize that." FA



Manager
Michael J. Cuggino

Age
53

Education
Bachelor's degree, Bentley University.

Professional Background
Various accounting, auditing and taxation capacities at Ernst & Young LLP and one of its predecessor firms, Arthur Young & Company. Served in various capacities at the Permanent Portfolio Family of Funds since 1993. His firm, Pacific Heights Asset Management, has managed the fund since 2003.

Outside Interests
Rollerblading, skiing, spending time with children.

Opinions and estimates contained in this article are subject to change without notice, as are statements of financial market trends, which are based on current market conditions. This article originally appeared in the January 2017 issue of *Financial Advisor* Magazine. All rights reserved. Charter Financial Publishing Network, Inc.