



RIA Profile: DAL Investment Company

“Go with the winners,” is the investment approach embodied in DAL Investment Company’s “Upgrading” strategy. “Market leadership is forever changing,” explained Sean McKeon, veteran portfolio manager and a principal of the firm. “By focusing on what’s doing well now, we systematically navigate our portfolios through the shifting trends of the market.”

Eschewing forecasting as an exercise in futility, DAL’s strict quantitative approach also ignores the personalities involved in fund management. By persistently monitoring total return, and ranking funds relative to others with similar downside risk each month, Upgrading relies solely on this risk-adjusted performance to be its guide.



Left to right: Sean McKeon, Marty DeVault, Janet Brown (President), Bernie Burke, Jason Browne

Established in 1969, San Francisco’s DAL Investment Company pioneered the use of no-load mutual funds. Today, DAL offers three distinct services that provide access to its Upgrading strategy: individual account management; a do-it-yourself investment newsletter; and, most recently, the FundX Upgrader Funds, a series of no-load mutual funds managed with the same investment principles. The FundX funds-of-funds are available to retail investors on most broker platforms.

DAL provides personalized portfolio management for private clients with assets of \$2 million and above. A team of 20 individuals, 5 of whom are investment managers, direct over \$2 billion in assets. Approximately one-third of the accounts are invested solely in the FundX Upgrader Funds. The other two-thirds consist of portfolios holding anywhere from 12 to 45 mutual funds. “For smaller accounts, utilizing the Upgrader Funds makes tremendous sense in terms of efficiency and ease for both us and our clients,” McKeon said. “We introduced the funds to allow a vehicle for smaller accounts that our clients wanted us to manage, but which we could not undertake. This offers a practical solution.”



A Resource for Other Advisors

DAL has entered into several sub-advisory arrangements by offering the FundX Upgrader Funds to advisors and financial planners seeking active management for client accounts in a turnkey environment.

“Advisors and financial planners seeking to improve results on the investing side of their practice have turned to DAL,” McKeon explained. “By utilizing DAL to implement the Upgrading strategy, advisors are able to streamline their own operations. This has allowed them, in turn, to provide improved service to their clients, as well as more time for marketing and outreach.”

“Advisors want to know their clients will be in a portfolio that is actively managed using a proven strategy with a long track record,” McKeon said. “Our 35 years of experience and trading expertise offers a real ‘value-added’ to professionals seeking a smart alternative for their clients.”

The firm is perhaps best known for its newsletter, NoLoad Fund*X, which it has published since 1976. Originally a source of hard-to-find performance data on no-load funds, the publication has evolved into a tactical investment tool providing trading guidance to its 14,000 subscribers, many of whom are advisors. The letter delivers mutual fund recommendations and the specifics necessary to apply the Upgrading methodology.

NoLoad FundX ranks number one among all investment newsletters for the past 10, 15 and 25 year periods on a risk-adjusted basis, according to the October 2007 issue of The Hulbert Financial Digest. The newsletter has attracted a growing wave of attention in recent years, which in turn has led to a swelling of DAL’s managed assets.

In 2001 the firm launched the FundX Upgrader Fund (ticker: FUNDX) as a means of handling smaller accounts. The firm’s core of devoted subscribers provide a strong, natural distribution channel for the new funds. There was a pent-up demand for such a vehicle among the newsletter subscribers, many of whom believe strongly in the system, but either lack the discipline to apply the strategy or are tired of managing their own portfolios and prefer to have DAL do the Upgrading for them.

When over \$160 million flowed into the fund in the first few months, DAL decided to introduce more-aggressive and more-conservative alternatives to the original portfolio to suit the varied risk profiles of its new shareholders. Currently the family consists of



seven distinct offerings, including two funds, introduced in January of this year, that invest only in ETFs.

Of the \$2.1 billion under DAL's management, 65% resides in the FundX Upgrader Funds. "It's definitely where our growth is coming from, and it's where we steer all but the largest of our new accounts. The FundX Upgrader Funds are simply a re-packaging of the same quantitative investment service we provide in our longstanding separate client accounts." McKeon observed.

The Upgrading Strategy

Flying in the face of much conventional wisdom about investing, Upgrading looks at near-term performance for its cues. The strategy exploits a well-documented phenomenon known as "persistence of performance." Funds that have performed well recently tend, on average, to continue to outperform into ensuing months. "While it is true that past performance is no guarantee of future results, studies have shown that short-term performance is really the only segment of historical performance that is at all predictive," McKeon explains. "This is supported by a good deal of academic research, such as the famous 'Hot Hands' study by Hendricks and Patel back in 1993, and later work by Grinblatt in '95 and Carhart in '97 and others since then. But the predictive value of short-term outperformance apparently dissipates after 6 to eighteen months. So it's important to continually monitor for rolling periods of performance of one year and less. We re-evaluate funds monthly, comparing them on a relative basis to their peers." When a fund drops below the 30th percentile in its class, it is sold and the proceeds moved into the highest-ranked fund available in that risk grouping.

The resulting portfolios are focused on those areas doing well, whether that be mid-cap growth, international value or large cap blend.

Managing Risk

A key to managing risk lies in DAL's classification of the funds in its universe. DAL groups equity funds into three categories, with "Class 1" holding the most aggressive concentrated funds, including most sector funds, leveraged indexes, single-country emerging market funds, and similarly aggressive offerings. Class 2 also contains aggressive funds, though not quite as concentrated as those in Class 1. These include diversified emerging market funds, small and micro-caps, mid-cap growth, etc. Class 3 lists DAL's core funds, diversified funds the firm recommends investors use to build the basis of their long-term growth portfolios. Class 3 funds tend to be larger-cap along with some mid-cap blend and value, as well as international and global funds that invest



primarily in developed economies (e.g., Europe and Japan). By grouping funds by downside risk, rather than by style or size characteristics, the system includes enough variety to allow for exposure to new areas as market leadership changes.

The approach also limits the exposure to more aggressive classes of funds, keeping risk to levels appropriate for each portfolio. The managers also take smaller and more numerous positions in the higher risk funds, thus avoiding excessive concentration.

Finally, the system calls for incremental movements in a portfolio rather than shifting large weightings into new areas all at once. This allows for a progressive movement to trends that have “legs”.

Focusing on Strengths

Several years ago, DAL began stepping back to do strategic business planning on a regular basis. Not only did the firm identify its strengths, they also defined what areas they would not pursue. “We don’t do financial planning, estate planning or taxes. That would be a distraction for us. People turn to us for one thing: applying the investment strategy that has brought us and our clients so much success. Most of our efforts go to fine tuning the Upgrading system and implementing the methodology in the best way we can.”

“Years ago, we managed our accounts as if we were several independent advisors working under one roof,” recalls McKeon, who joined the firm in 1990. “We’d meet to make investment decisions and then go off to implement those decisions in our own client accounts individually. Eventually we recognized the need to streamline the investment process, centralize trading, and work toward a more cohesive approach. The process was difficult and took several years, but it was worth the effort. It allows us to do more and better strategic planning and, most important of all, to devote resources to the research necessary to improve the investment system.”

DAL conducts ongoing back-testing using proprietary software and, more recently, [Amibroker](#). The firm constantly examines how the system might react to such variables as the influx of new funds, how best to classify funds, the number of funds in a portfolio, and what holding periods and sell thresholds offer the best potential returns with the least amount of acceptable risk. “The mutual fund industry never stops changing, so we can’t stop questioning how best to implement our momentum-based discipline in the real world.”

Longtime users of Schwab’s Portfolio Center (formerly Centerpiece), DAL implemented



its modeling features to create more uniform portfolios in client accounts. “We eventually exhausted the possibilities of Portfolio Center’s modeling capacities,” McKeon said. “By the time we abandoned that route we had over 150 models in about 500 accounts. And that was just for the equity components of the portfolios! It became very unwieldy.” In the past year the firm brought in the Charles River order management system, which has transformed the trading process for the group.

“We realized we needed an OMS to generate the kind of compliance reports needed to document best execution on our Upgrader Fund trades,” McKeon said. “After a failed attempt to build a trading system from scratch with an outside software company, we opted to bring in Charles River, at considerable expense, because it could solve our modeling problems with the separate accounts as well.”

The results have been gratifying. “Trading, particularly in ETFs, is an area in which we feel we really add value. And this has attracted the attention of other advisors who lack that expertise.”

www.advisorperspectives.com

For a free subscription to the Advisor Perspectives newsletter, visit:
<http://www.advisorperspectives.com/subscribers/subscribe.php>