Process Over Prediction

Why we think durable outperformance comes from investment process, not from forecasting markets

KEY TAKEAWAYS

- The pursuit of benchmark-beating returns is often framed as a forecasting exercise. Industry studies consistently show that active managers underperform their benchmarks over multi-year periods.[1]
- In our opinion, what separates the minority who do outperform is rarely better prediction. It is a more disciplined investment **process**, research depth, position sizing, risk management, and consistency.
- For investors evaluating active strategies, the question isn't can the manager predict the market, it's **is the manager's process repeatable and tested across market cycles?**

Overview

The case for active management presupposes the possibility of outperformance. The evidence on whether that possibility is consistently realized is sobering. S&P Indices Versus Active (SPIVA) and similar industry studies have consistently shown that a majority of actively managed funds underperform their benchmarks net of fees over five- and ten-year horizons.[1]

For some investors, this is reason to default to passive strategies. For others, it raises a more useful question: what does the minority of managers who do outperform have in common? In our opinion, the honest answer is not better prediction. It is a more disciplined process, applied with consistency over time.

Why It Matters

In our view, investors choosing active strategies are generally paying for skill, so they need a working definition of what skill looks like. A common interpretation is that skill means forecasting: calling tops, picking the next sector winner, timing exits before drawdowns. The data on tactical timing is unforgiving. Strategies built around prediction look brilliant when they work and severe when they don't.

We think a more useful interpretation of skill is **process integrity**: disciplined application of a repeatable framework across many market environments. In our experience, process produces durable results not because the manager is always right, but because results may be partially attributable to the framework intended to prevent mistakes from compounding over time.

How It Works

A strong investment process has identifiable, evaluable components.

Prediction-Based

ATTEMPTS TO CALL THE MARKET

May emphasize forecasts regarding market direction, economic conditions, or specific events when making investment decisions. Forecasts may not occur as anticipated.

Process-Based

APPLIES A FRAMEWORK

May emphasize a defined framework for research, portfolio construction, position sizing, and risk management. The effectiveness of the framework may vary across market conditions.

Research depth. In our view, outperformance starts with information advantage, usually not from having unique data, but from analyzing widely available information more rigorously: macro context, thematic research, security-level fundamentals.

Position sizing. Convictions have to translate into portfolio weights. A high-conviction view in a 1% position may not move returns. In a 5% position, it may. Sizing is one dimension of active management we believe to be most consequential and under-discussed.

Risk management. Many process-driven managers have frameworks for what they will and won't own, how much they hold, and what triggers a reduction. This can be valuable when conviction is highest and over-concentration is tempting.

Consistency across market cycles. We think the most reliable signal of process integrity is application, applying the same framework in a tech-led bull market as in a defensive value rotation. Process that flexes with the market is not really process.

Practical Implications

For advisors and investors evaluating active strategies, three potential takeaways follow.

1. **Evaluate managers on process, not recent performance alone.**
Strong recent returns may reflect skill, favorable conditions, or both. They are not, by themselves, a reliable signal. The same is true in reverse.

2. **Look for evidence of process across multiple regimes.**
How did the manager position in various market cycles? A manager who applied the same framework through each is showing you the process.

3. **Consider forecast-driven approaches carefully.**
Market forecasts are inherently uncertain. Consider how much a manager incorporates forecasts into a broader investment process and how the strategy may respond when market conditions differ from expectations.

At Clough Capital

Clough Capital's investment approach integrates macro context, thematic research, and bottom-up security selection, applied through a process refined across more than two decades of market cycles. Chairman and CIO Chuck Clough's Macro Compass reflects the spirit of the firm's process: it does not attempt to predict, rather it builds arguments from signals, historical precedent, and causal reasoning.

IMPORTANT DISCLOSURES

Investors should consider the investment objectives, risks, charges, and expenses carefully before investing. This and other information are contained in the prospectus, which may be obtained by visiting www.cloughcapital.com/etfs or by calling 855-393-0559. Please read the prospectus carefully before you invest.

Active management involves higher fees and the risk of underperformance relative to passive alternatives. There is no guarantee that an active strategy will outperform its benchmark or that any investment objective will be achieved. The success of an actively managed strategy depends on the portfolio manager's skill, research process, and judgment, all of which involve risk. Past results do not predict future results.

The Clough Capital ETFs are distributed by Paralel Distributors, LLC. Paralel Distributors, LLC and Clough Capital are not affiliated.

This material is for informational and educational purposes only and does not constitute investment advice, an offer to sell, or a solicitation of any offer to buy. Information has been obtained from sources believed to be reliable but is not guaranteed. Views expressed represent the opinions of Clough Capital and are subject to change without notice.

There is no assurance that any investment process, strategy, research methodology, risk-management technique, or portfolio construction approach will result in favorable investment performance or outperform a benchmark. Market forecasts and projections are inherently uncertain, may not occur as anticipated, and should not be relied upon as an indication of future results. Investment processes and portfolio positioning may change over time in response to market conditions, investment opportunities, and other factors. One cannot invest directly in an index.

[1] Source: S&P Dow Jones Indices, S&P Indices Versus Active (SPIVA) U.S. Scorecard. SPIVA scorecards are published semiannually and compare actively managed funds against their benchmarks.

BOND190