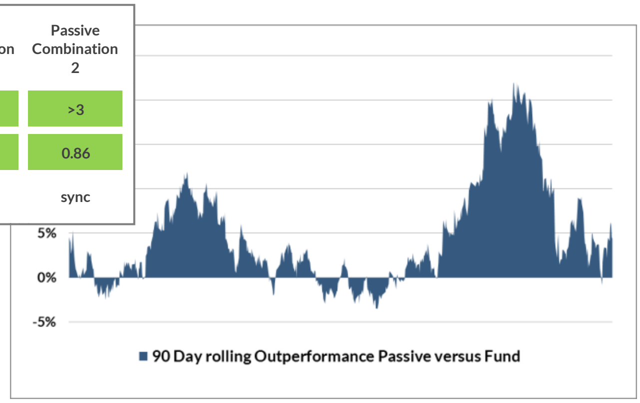
Passive Replication / Benchmarking

Subject

We were consulted to review an existing portfolio position, a mutual fund (UCITS) in the category „liquid alternatives“. Criteria on management team, operational risks as well as incentive structure had to be incorporated to analyze and provide a recommendation. Focus was on investment strategy. Is it implemented as mentioned by the manager and suggested in public material? Does the strategy rely on passive factors or risk premia that could be replicated without an active manager?

	Passive 1	Passive 2	Passive 3	Passive 4	Passive Combination 1	Passive Combination 2
Return Multiple	>3	2.21	1.85	>3	>3	>3
Risk Multiple	1.22	0.67	0.65	1.04	0.89	0.86
Loss Periods	sync	sync	sync	sync	sync	sync



Our Role

The analysis started with our extensive catalogue of criteria to find negative aspects concerning the fund, the strategy or the management. Incentive and team structure as well as the operational setup would not have led to a negative conclusion. Statements from the management on alpha generation, on portfolio positions, and on the risk management approach gave us an early indication – without looking at the figures - that the strategy could be replicated with passive vehicles.

Using this benchmarking approach, we respect the skills of managers. A passive replication should not be possible to build ex post only, it has to be easily available and achieved with only a few factors. Otherwise, focusing on the past, any strategy can be replicated with a combination of passive factors. Real skills of managers would then be ignored by over-optimized simulations of historical time series data. A qualitative assessment is inevitable.

In the present case, a combination of instruments that are available and accessible, exhibited significant risk-adjusted outperformance. Loss periods occurred in sync with the active strategy. The outperformance was generated continuously.

In addition, the management showed no intention to continuously develop the strategy – another shortcoming.

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