TRENDRATING

INVESTMENT DISCIPLINE THAT OUTPERFORMS

Trendrating

New Direction for an Actively Managed Certificate (AMC)

I. Introduction

Markets exhibit significant return dispersion in all types of market conditions and this cross-sectional dispersion in returns should make a compelling case in support of active management as the opportunities to outperform underlying benchmarks is real. Yet according to SPIVA[1], 80% of US active funds and 79% of European active funds underperform their respective benchmarks over a 3 to 5 year horizon.

It is Trendrating's belief that this underperformance of general funds coupled with the real opportunities to outperform, offers issuers of AMCs the opportunity to offer the market equity products that have the potential to outperform. With this in mind, Trendrating has launched its Systematic Management Solution (SMS), a platform that supports the creation and management of active strategies underpinned by Trendrating's Trend Capture Model. SMS enables you to efficiently construct, test, optimize and manage systematic equity.

II. Return Dispersion

The dispersion of stock returns within any given investment universe is a fact that is often overlooked, but one that can have a meaningful impact on the performance of investment strategies. It provides a real opportunity for active managers to extract superior returns from the opportunity set, and deliver outperformance relative to underlying benchmarks and competing passive strategies even after adjusting for management fees.

Table 1 & Table 2 examine the annual return dispersion between the winners and losers in two investment universes, USA and Developed Europe. For each calendar year, we calculate each stock's return over the year, and then divide the universe into quintiles based on their annual performance. Quintile 1 contains the average return for the top 20% performing stocks and Quintile 5 contains the average return for the bottom 20% performers.

Table 1:	USA		
Year	**Universe**	**Quintile 1**	**Quintile 5**
2008	-35.46	-0.17	-68.80
2009	43.24	137.17	-8.23
2010	20.21	61.56	-10.85
2011	-0.66	35.36	-35.20
2012	19.79	66.79	-10.48
2013	33.21	78.58	-5.07
2014	16.10	54.96	-13.09
2015	-0.02	32.43	-29.40
2016	10.95	46.60	-18.40
2017	18.25	65.77	-18.43

Table 2:	Developed	Europe	
Year	**Universe**	**Quintile 1**	**Quintile 5**
2008	-38.34	-6.21	-67.21
2009	41.34	122.88	-6.51
2010	20.50	88.79	-19.45
2011	-11.45	26.03	-42.30
2012	21.13	66.66	-13.36
2013	27.10	77.92	-7.95
2014	9.36	47.53	-19.03
2015	11.87	63.69	-24.82
2016	8.88	58.33	-22.14
2017	17.52	57.28	-11.58

Whilst the annual differential between these two groups might vary in magnitude, the central point is that the differential is significant, hence the opportunity to outperform exists in all types of market conditions.

The return dispersion presented in this table represents the theoretically best outcome that would be possible with the benefit of hindsight, nevertheless, the amount of dispersion between the best performing set and worst performing set

[1] S&P Indexes vs. Active

is so large, that a mechanism that has efficacy in separating potential winners from potential losers would lift portfolio returns by a significant amount.

III. Why Trend Capture

The empirical evidence is irrefutable that markets exhibit dispersion in stock returns in all market phases, so it is the responsibility of active managers to find ways to profit from this return dispersion. Aligning long/overweight positions with a positive exposure to securities that are exhibiting positive price trends, and avoiding/underweighting securities that are exhibiting negative trends is an effective and efficient framework for consistent return capture.

The analysis of price trends and incorporating trend capture into the decision making process will increase the probability of being positioned in the segment of the market that is most likely to outperform because as return dispersion proves, no matter the type of market regime, there are always winners and losers in the market.

IV. The SMS Edge

SMS allows the user to fully outsource the portfolio management workflow to the platform. The Strategy Builder (SB) module supports the research, design, and back testing of a portfolio construction strategy powered by the Trend Capture Model as well as an additional number of factors and parameters. Once the user is satisfied with the strategy's simulated result, he/she can deploy a Systematic Portfolio (SP) based on the SB strategy of choice. The SP is essentially the product that the user has deployed on the SMS platform as the SP keeps track of all the rebalanced historical portfolios as well as the daily holdings whose weights are adjusted for market movements.

SMS affords the user considerable flexibility in managing trade lists and rebalanced portfolios to ensure that the holdings stored within the platform mirror the actual holdings that the user implemented in the live product. It also tracks daily performance and the rebalancing process is user driven but automated so that rebalancing is not an onerous task but yet offers complete flexibility.

V. Conclusion

The altered dynamics in equity markets are creating an enormous challenge for active managers to outperform their benchmarks, and the report card clearly shows that the majority are failing to achieve their objectives. However, markets continue to exhibit return dispersion between winners and losers continues, which means that the decision processes being used by investment managers are missing vital tools to profit from this inherence return dispersion.

Price trends are getting stronger and increasingly disconnected from underlying fundamentals, and offer an alternative framework for deploying equity products that have the strong potential to outperform. The SMS platform simplifies the workflow of designing a new AMC, and the production capability within the platform supports the portfolio manager in making the management of the AMC a painless process. It offers issuers of AMCs the potential to add scale to their product suite.