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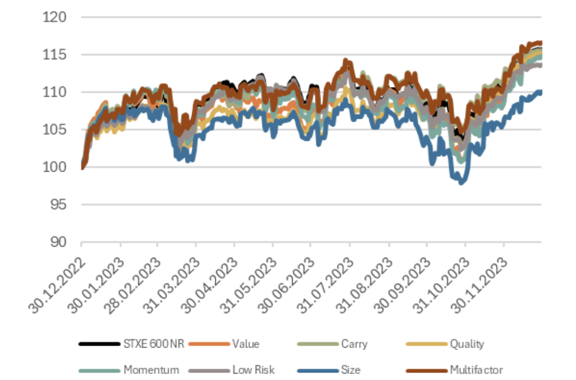
Riskpremia – Made in Germany

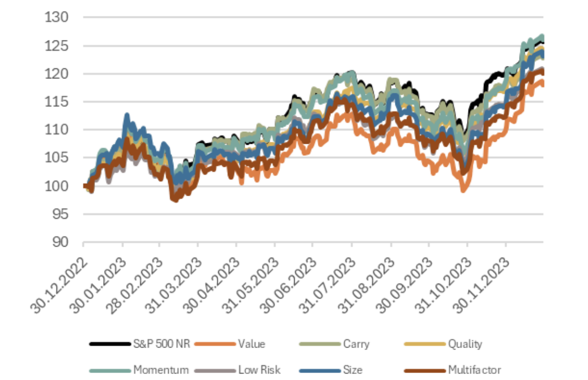
Long/Short Performance still exceeds Smart Beta Excess Returns

Smart Beta factor investors exhibited another difficult year in 2023 – across factors, regions and providers of different factor strategies. The challenging environment of the last couple of years continued and when looking at the performance of iSTOXX factors in aggregate within Europe and US, it seems if 2023 hit rock bottom again in relative performance terms. In contrast to the last couple of years, where always one or two factors outperformed – **none of the six typical single factors registered positive excess returns vs. benchmarks in Europe**. Momentum within US was an exception, outperforming by +0,5% - in an otherwise similar setup.

Europe



USA



Europe	Long Only	Excess +/-
Benchmark	15,80%	
Value	15,04%	-0,76%
Carry	15,66%	-0,13%
Quality	15,23%	-0,57%
Momentum	14,81%	-0,99%
Low Risk	13,77%	-2,03%
Size	10,06%	-5,74%

USA	Long Only	Excess +/-
Benchmark	25,7%	
Value	18,0%	-7,6%
Carry	22,8%	-2,8%
Quality	24,0%	-1,7%
Momentum	26,1%	0,5%
Low Risk	20,7%	-5,0%
Size	23,2%	-2,5%

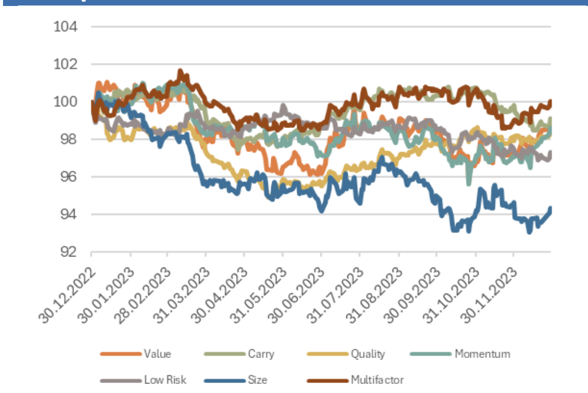
The ongoing underperformance of factors in Smart Beta space is seen as a huge problem and after a couple of years of underperformance- especially in value and size, **more researchers start to criticise the empirical findings** as well as the current methods to harvest the different factor premia. One of the most prominent is M. Lopez de Prado, a highly recognized quantitative researcher currently working for Abu Dhabi Investment Authority. In his new, recently published book "Causal Factor Investing", (Cambridge University Press), he tries to answer the question, **if "factor investing can become scientific"**? His critique is general in nature as **he believes, empirical factor investing research lacks the rigorous discipline of other sciences**:

“Virtually all journal articles in the factor investing literature make associational claims, in denial of the causal content of factor models. Authors do not identify the causal graph consistent with the observed phenomenon, they justify their chosen model specification in terms of correlations, and they do not propose experiments for falsifying causal mechanisms. Absent a causal theory, their findings are likely false, due to rampant backtest overfitting and incorrect specification choices.”

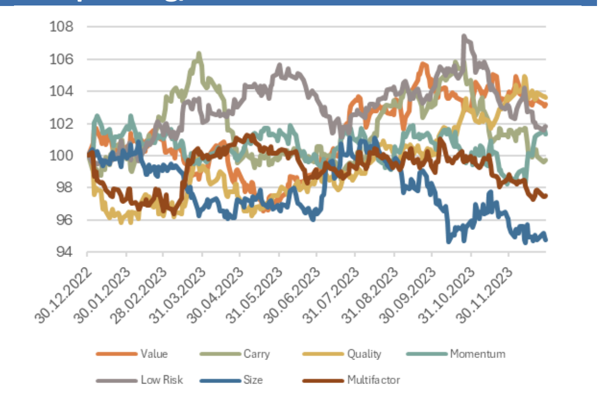
Apart from the fact, that **we agree with many critics in factor space** - we have written about that from time to time (i.e. “The Smart Beta Mirage” / 2021) - the reasons for aggregate factor underperformance might be simpler.
On the one hand, **all risk premia** - traditional as well as alternative - **are a compensation for bearing systematic risk and are prone to larger and longer phases of drawdowns** than normal distributions predict - and investors believe. Some of the best examples are the equity risk premium in Japan from 1989 – 2020 or the recent drawdown in US treasuries, where 20+ yr. bonds lost 44% between 2020 and 2023 - similar to the S&P 500 index decline of 50% during the GFC from 2007-2009. Moreover, given that risk premia always represent excess returns above cash - and **cash delivered ~10% over the last three years -**, it will be difficult for treasuries to recover from a 50% underperformance against cash over the near future.

On the other hand – **the recent underperformance of all factors is a special phenomenon in Long Only Excess returns**. Long/Short looks different – especially for 2023 – even recognizing that Value and Size underperformed in Long/Short as well since their peak in 2017. The high concentration in a few large cap stocks seems to be the main reason to us.

Europe Market neutral



Europe Long/Short



Europe 2023		Market neutral	Long/Short		Difference
Value		-1,37%	3,19%		4,56%
Carry		-0,91%	-0,25%		0,65%
Quality		-1,46%	3,63%		5,09%
Momentum		-1,39%	1,35%		2,74%
Low Risk		-2,62%	1,85%		4,47%
Size		-5,67%	-5,24%		0,43%

Long/Short delivered positive returns in four out of six single factors and outperformed Market neutral (Long Only, hedged beta-neutral with futures) in all cases. Size performance is similar and Carry, which was the best single factor in Market neutral, was second weakest in Long/Short.

Conclusions:

Long/Short still seems to offer more opportunities than Smart Beta with respect to factor excess returns. In the light of still high index concentrations, performance opportunities are smaller in benchmark relative factor strategies. Especially short legs can be implemented more efficiently in Long/Short as they are not determined by a benchmark index. In a nutshell, the same research output delivers different performance numbers and risk adjusted returns with different implementation methods.

As many investors are constrained with respect to Long/Short because it´s a different “asset bucket” compared to Long Only equities, they should think about a “Portable Beta” implementation – a combination of a benchmark exposure with a Long/Short factor strategy in one portfolio or product.

Alpha Centauri Indexing - Data as of 29.12.2023

Description:

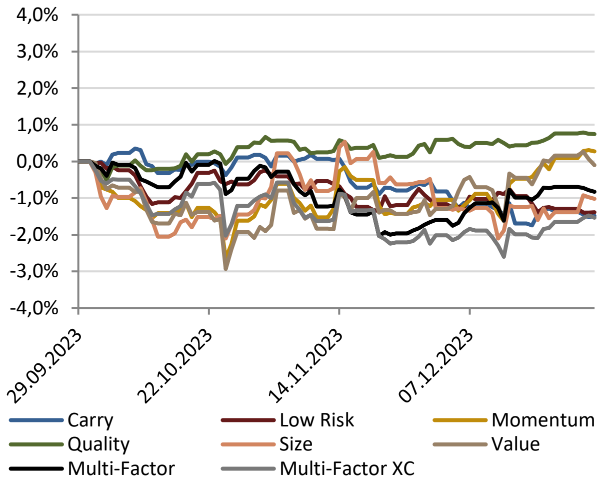
The iSTOXX Europe Single Factor index family developed by STOXX in collaboration with Alpha Centauri offers investors a unique and very innovative way to target and capture premia.
It consists of six single factors that aim to capture well-known risk premia and one multi-factor that aims at simultaneously capturing premia from the aggregate of all single factors rather than from just one source of risk alone.
All indices are constructed to maximize the exposure to their particular factor and minimize unwanted risks. While constructing the final indices the FIS APT risk model is used to measure and restrict risk.

For more information go to **www.alpha-centauri.com** or **www.stoxx.com**

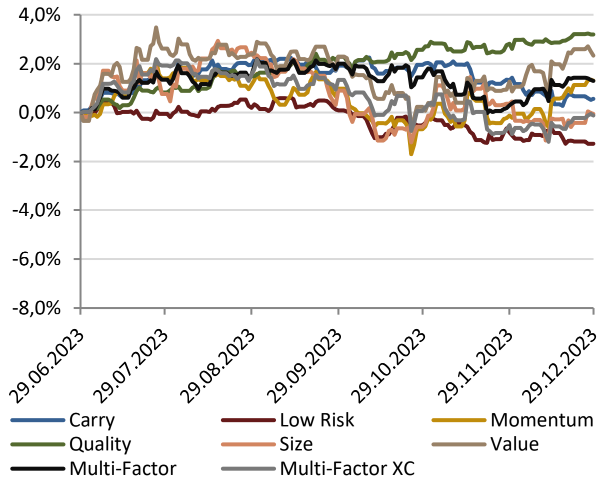
Performance and Volatility Breakdown

Name	Ticker	Return 3 Months	Return 6 Months	Return 12 Months	Return Live (1.4.)	Vola pa	Vola pa Live (1.4.)
Carry	ISECFER Index	5,2%	6,2%	14,2%	83,3%	13,8%	13,5%
Low Risk	ISERRER Index	5,3%	4,4%	12,5%	82,5%	12,8%	12,6%
Momentum	ISEMFER Index	7,0%	7,0%	13,7%	66,4%	13,7%	13,4%
Quality	ISEQFER Index	7,5%	8,9%	13,9%	72,1%	13,6%	13,3%
Size	ISEZFER Index	5,7%	5,6%	8,8%	55,2%	13,5%	13,3%
Value	ISEVFER Index	6,6%	8,0%	13,6%	15,6%	14,8%	14,5%
Multi-Factor	ISEXFER Index	5,9%	7,0%	15,2%	60,9%	13,1%	12,8%
Multi-Factor XC	ISEXFCR Index	5,2%	5,6%	13,3%	62,5%	13,2%	12,8%
Benchmark	SXXR Index	6,7%	5,7%	14,3%	75,9%	13,9%	13,6%

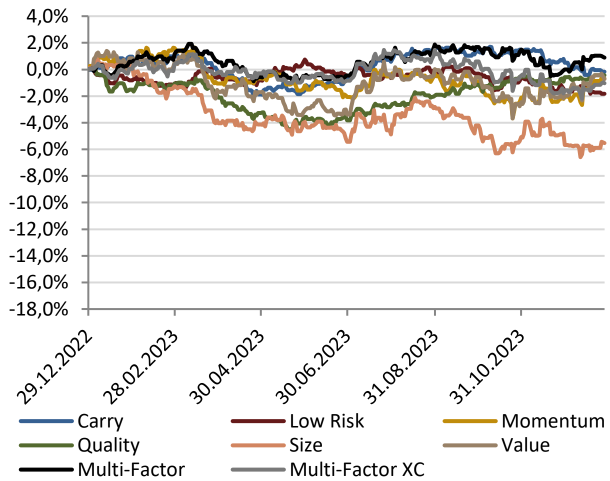
Excess Return 3 Months



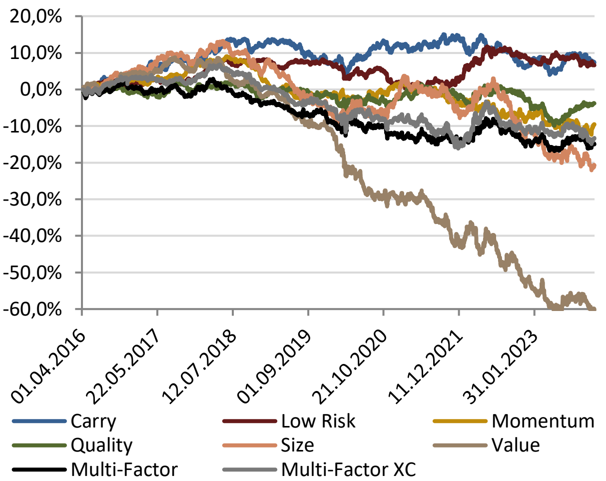
Excess Return 6 Months



Excess Return 12 Months



Excess Return since going Live (1.4.2016)



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