

## Somewhere to hide

Tuesday, 05/21/2019

There is not much that investors can be certain of these days as economic indicators seem to flip one month to the other and consensus sentiment swings from too much rate hiking to too little and from undervalued to over. Add to this abnormal market behavior like the divergence in volatility for bond and equity markets, investors are finding it difficult to perform their asset allocations. The OYSTER Equity Premia Global fund offers a viable investment solution to this problem as it has little correlation to both fixed income and equity while providing strong returns over the long-term. It provides a desirable alternative were equity markets to fall or interest rates rise again.



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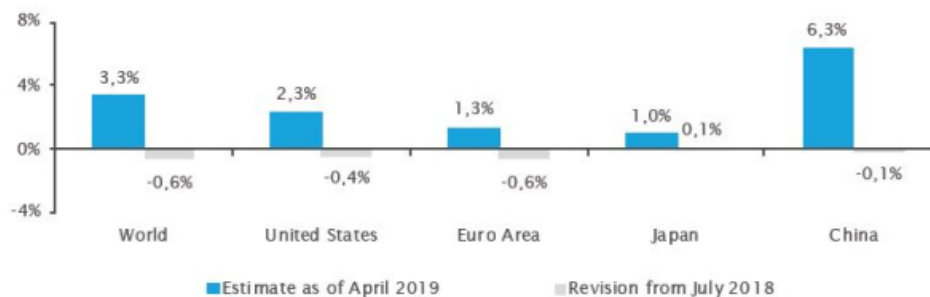
*"With uncertainty and the unexpected everywhere, from the return of negative government bond yields in Europe to U.S. presidential tweets, investors are rightfully searching for an anchor point away from traditional asset classes."*

### Goldilocks, Silverlocks or something else?

Since 2017, market participants have been enjoying a "goldilocks" environment where accommodative monetary policies support "just right" economic growth and inflation. This idyllic situation did not last for long; goldilocks was mauled by bears in the second half of 2018. China's domestic consumer spending weakened amid trade wars and confidence in the euro area dropped. External demand, especially from emerging Asia, softened. Germany and Italy flirted with technical recessions, while prospects of an disorderly Brexit dented confidence. This global malaise led to downward revisions to GDP growth estimates (chart 1) and financial markets paid a heavy performance price.

This dull picture improved somewhat in 2019 when the Federal Reserve slammed the brakes on additional rate hikes, creating a "silverlocks" condition where monetary policy once again became accommodative, but this time in a less than robust economic backdrop. The return of dovish policy was welcome at first but has since created markets with feet of clay. Price appreciations have been the result of cheap money rather than economic growth, making valuations extremely fragile.

### 2019 GDP growth estimates reductions



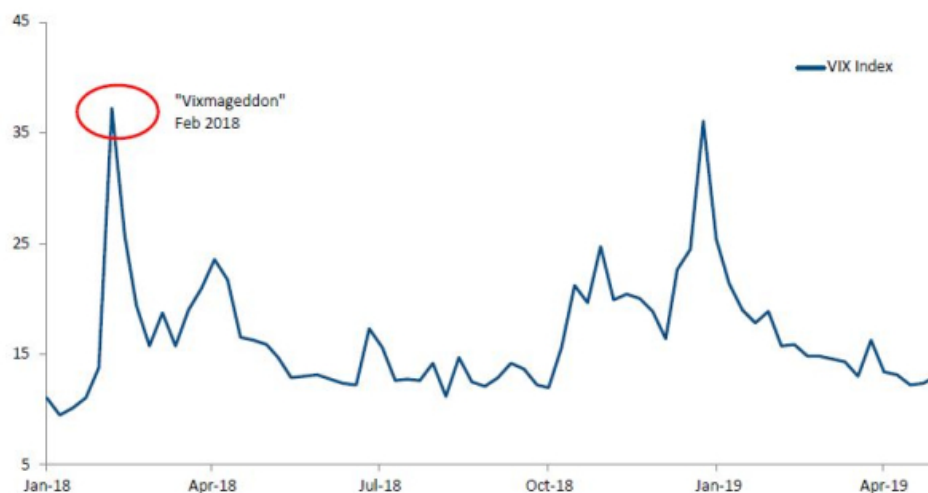
Source

IMF World Economic Outlook. Data as at: 04.19

## Something is not right...

The delicate valuation of equity markets is not the only source of worry for investors. The VIX index, also known as the "fear indicator" of the stock market, currently displays levels more than 30% below the average of the last 30 years.

### VIX settles back into low-volatility doldrums



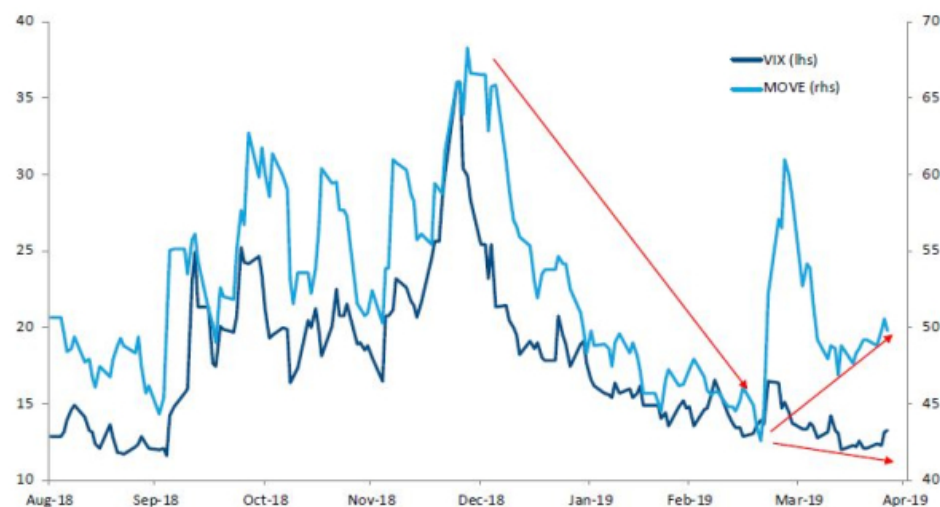
Source

Bloomberg. Data as at: 30.04.19

The low VIX can be partly explained by a record net negative position as hedge funds have been shorting the index at a rate not seen in 15 years. These aggressive bets are making many market participants anxious, as the seduction of easy money already roiled markets in February 2018 where many volatility ETFs imploded in a "vixmageddon", exacerbating stock market turmoil (chart 2).

Another indication of possible disturbances to come is the recent divergence between the VIX and the MOVE, the volatility index for bond markets. These two indices tracked closely during the sell-off in Q4 2018 and the ensuing recovery in Q1 2019 but have since gone in different directions (chart 3).

### Bond vs equity market volatility



Source

Bloomberg. Data as at: 30.04.19

This break-down in the relationship between bonds and equities is a source of concern for investors who use this historical correlation to reduce the volatility of their portfolios. Many also wonder how to allocate between bonds and equities when both asset classes are behaving anomalously. After all, it's hard to see how markets can maintain their blistering pace; we would have to believe that 2019 annualised returns will be in the 10 - 20% range for bonds and 55 - 65% for equities!

### Reduce risk but retain return

The confluence of uncertainties – the abnormal volatility regimes and the possibly overextended economic cycle – presents a conundrum for investors who wish or must remain invested but are seeing the risks to the downside.

The OYSTER Equity Premia Global fund offers a viable solution to investors looking to reduce the sensitivity of their portfolio to traditional asset classes. It has little correlation to both equity and bonds while providing strong returns over the long-term. This would be a desirable characteristic were equity markets to fall or interest rates rise again.

The fund's global investment universe helps weather idiosyncratic risks by diversifying in multiple regions, countries, sectors, industries, styles, and size. Through as many as 900 single positions split between the long and short portfolios, OYSTER Equity Premia Global seeks to extract alpha in as many places as it can be found without relying on rising markets or rate movements. Its systematic approach provides the added benefit of eliminating the emotional biases that discretionary managers suffer from, particularly in periods of high uncertainty. The fund is rebalanced at least quarterly and a stringent risk management process ensures that beta neutrality and its 6% volatility target are achieved.

### Certain uncertainty

With uncertainty and the unexpected everywhere, from the return of negative government bond yields in Europe to U.S. presidential tweets, investors are rightfully searching for an anchor point. And this anchor point must also achieve the same risk-adjusted returns investors have enjoyed in a mix of traditional asset classes in the past ten years but which are unlikely to be reproduced in the next ten. With a targeted return of LIBOR + 5% and its very low correlation to traditional assets, OYSTER Equity Premia Global presents an liquid alternative solution for investors seeking transparent and cost-effective diversification. It offers somewhere to hide for investors caught in a market environment that will continue to be erratic and unpredictable.

### One product, many ways to implement it

As equity premia products remain outside the mainstream, it may be helpful to suggest some ways that an investment in OYSTER Equity Premia Global can be integrated into existing portfolios.

1. Replace hedge fund allocations – OYSTER Equity Premia Global offers similar risk and return characteristics, but through a more cost-effective and more liquid implementations (UCITs structure with daily liquidity);
2. Fixed income overlay – low yields for investment grade bonds means that there are opportunity costs to diversification. The fund can be used to reduce duration by adding it to a fixed income portfolio while retaining higher returns.
3. Risk-mitigation bucket – the fund could be combined with trend-following strategies to increase portfolio diversification without the lower returns of more traditional diversifiers;
4. Pro rata diversification – as the fund targets a return of LIBOR + 5%, similar to many institutional portfolios, a pro rata allocation to a diversified portfolio is common.

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