

The SYZ Absolute Return strategy: successfully navigating changing markets for the past 15 years

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The rise of equity and bond correlations over the past decade, in particular during periods of market dislocations, has meant that investors have been forced to find alternative ways to achieve diversification in down markets.



Fabrizio Quirighetti
Macroeconomic
Strategist

"We aim to separate ourselves from the crowd when things go wrong – when active management is most needed."

- Recent market volatility has led investors to take a fresh look at risk control – well beyond traditional correlation assumptions.
- Multi-Asset portfolios must, in our view, be managed dynamically in order to find opportunities across asset classes.
- Flexible approach needed to both protect capital, but also generate returns.

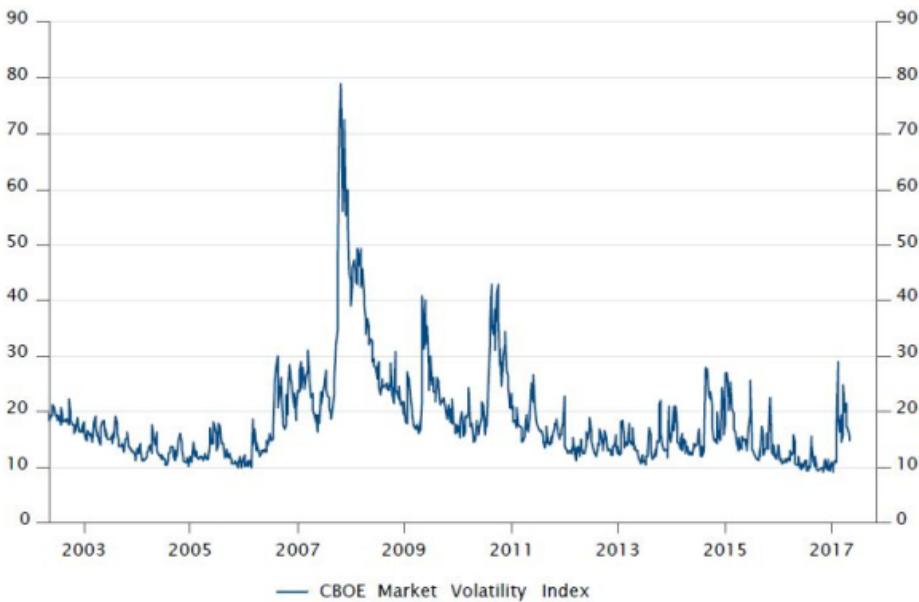
A 2005 déjà-vu ?

Investors have enjoyed many fruitful years since the 2008 financial crisis, with asset classes having risen steadily in value pretty much across the board as central bank intervention has inflated their prices. There have been relatively few interruptions to their increases over this time, and such was the calm ride that investors enjoyed through the end of 2017, many seemed to have been fooled into thinking that volatility was a thing of the past.

The events of the first quarter of 2018 shattered this perception as concerns about inflation combined with stretched equity valuations led to volatility returning with a vengeance.



VIX (weekly data)



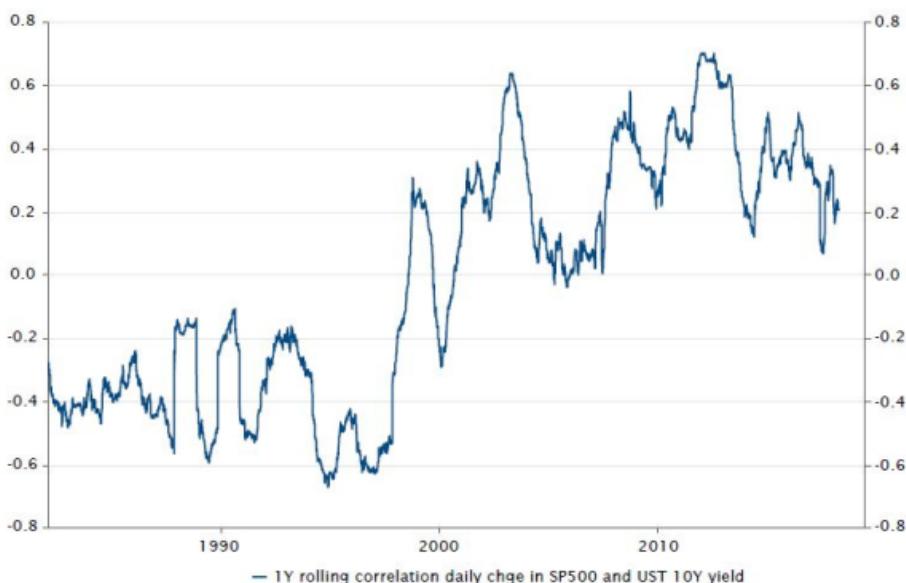
Source

FactSet Research Systems, SYZ Asset Management. Data as at: May 2003 to May 2018

Historically, government bonds in a traditional equity-bond balanced portfolio would have protected its performance when equities were falling. But today, with yields still close to historic lows (and real rates below zero), fixed income can no longer be relied upon to provide adequate diversification to an equity allocation – as it was unable to in February. The rise of equity and bond correlations over the past decade, in particular during periods of market dislocations, has meant that investors have been forced to find alternative ways to achieve diversification in down markets.

Bonds-equities correlation

Correlation won't change in a sustainable manner as long as the central banks put isn't removed



Source

FactSet Research Systems, SYZ Asset Management. Data as at: January 1982 to May 2018

In this kind of environment, we believe that investors should look beyond traditional equity-bond balanced portfolios to more dynamic strategies that deploy a greater range of asset classes to provide the diversification they need. Such multi-asset solutions should be flexible enough to cope with rapidly changing market conditions, while also incorporating strict risk management techniques to preserve value.

The SYZ Absolute Return strategy: a defensive multi-asset solution, with fixed income at its heart, that has delivered consistent, attractive long-term returns

We believe that our Absolute Return strategy ("ARI") could be an ideal solution for investors looking for a defensive, multi-asset portfolio. It could be used to replace, part of their allocation to fixed income if they have concerns about interest-rate risk and high bond valuations as it is in essence a fixed income strategy that tactically uses equities and other asset classes (such as currencies) as a source of diversification and return. It is long-only and managed according to a fundamental approach, so all of its decisions can be readily explained and are fully transparent.

Created in 2003, the strategy has built up an excellent track record – rising in value in 14 out of 15 years, including in 2008 and 2011, which were notoriously difficult years for investors. The one year it did fall in value – 2015 – it limited its loss to just 0.5%*. What's more, the strategy has had just one manager – Fabrizio Quirighetti – over this whole period, so its track record can be attributed to one person's consistent, tried-and-tested style and approach.

**Performance is based on OYSTER Absolute Return GBP class I M GBP.*

10 years of performance ARI GBP

Chained track record: SYZ AM (LUX) SICAV Absolute Return. Institutional GBP I2 from 30.04.2008 till 19.12.2014. Thereafter the fund merged with OYSTER Absolute Return I M GBP.



Source

Source: SYZ Asset Management. Data as at: 30 April 2018

But the manager does not work in isolation. While Fabrizio is the ultimate decision-maker, he benefits from the input of the 15 other members of SYZ's Investment Strategy Group (ISG). The ISG includes multi-asset, equity, credit and quantitative investment experts who share their views on their areas of specialism.

This unit's in-depth research capability enables us to exploit investment opportunities over 20 countries, as well as forming views on the economic cycle and cross-asset correlations. With the ARI strategy able to allocate across a wide universe of instruments to achieve its objectives, the ISG helps Fabrizio build a framework around which he can choose to implement his investment decisions. All of this is vital in the successful management of a multi-asset portfolio.

Since inception performance ARI EUR.

Chained track record: SYZ AM (LUX) SICAV Absolute Return Institutional EUR I2 from 30.11.2008 till 19.12.2014. Thereafter the fund merged with OYSTER Multi-Asset Absolute Return I EUR PF.



Source

SYZ Asset Management. Data as at: 30 April 2018

A philosophy built around the desire to preserve capital while generating attractive absolute returns

The need to preserve capital lies at the very heart of the strategy's development. Back in 2003, we were approached by a European life insurance company looking to diversify its fixed income allocation as it was concerned that interest rates were too low and that the only way they could go was up.

While the company may have been a little too early with its interest-rate call, its investment aims have helped us to learn a lot. When it approached us it only invested in fixed income and was keen to diversify to increase its return potential, while at the same time avoiding putting its capital at risk. The client looked closely at the strategy's returns on an ongoing basis, and wasn't happy if there was a single down-month. This was very instructive for us, and this philosophy of very carefully producing performance with only a limited risk budget has been instrumental in the strategy's success over the ensuing 15 years. It has forced us to allocate risk extremely carefully, and only to areas that we believe have a very high chance of rising in value.

A flexible approach

An integral part of the strategy is its flexibility. This has been very important in enabling it to outperform in markets that have changed considerably over the years. Rather than launching a new strategy in an attempt to capitalise on new market developments over the past 15 years, we have sought to adapt the way we manage the strategy without any need to change its underlying philosophy.

For example, over the past two or three years we've made greater use of derivatives to hedge duration and because the correlation of equity and bond returns has increased over this time. Another change is that before 2008, we only held cash in short-term deposits, but the problems that year with counterparty risk led us to start directly holding more floating-rate notes and short-term bonds. The way that we manage the strategy's equity bucket has also evolved: before 2008 it used to have a passive bias, but nowadays we're allocating more to, for example, emerging equities. Similarly, it's only in the past three or four years that we've been investing in emerging debt.

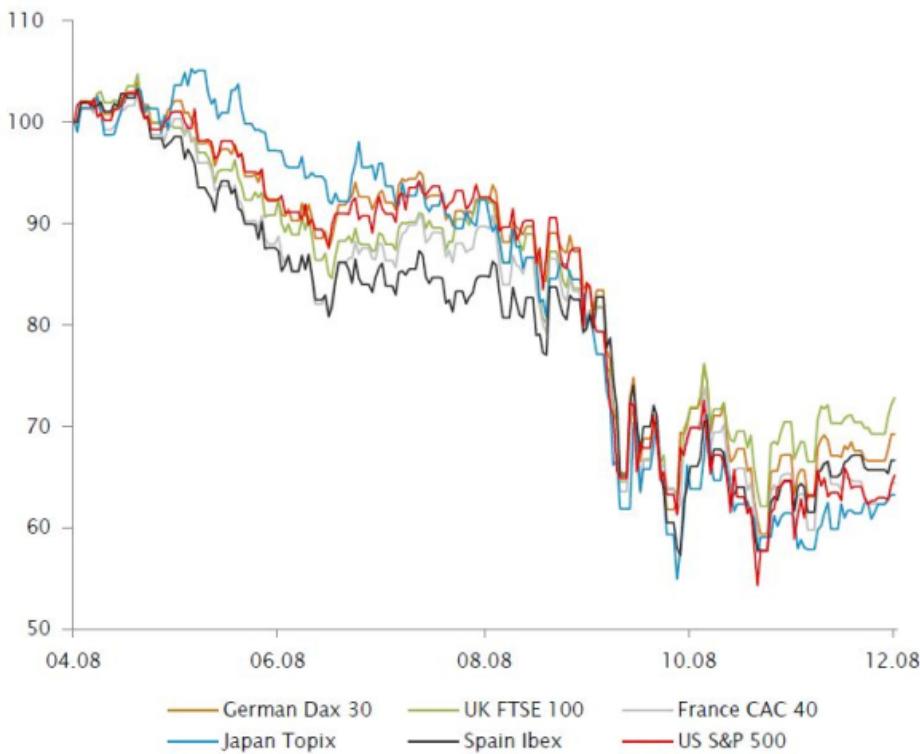
But there has been no change in the strategy's guidelines to allow these changes: we've simply adapted our approach in the face of new developments and to exploit new sources of return. We continue to respect the strategy's initial guidelines.

PERFORMANCE IN FOCUS: 2008

2008 was a terrible year for investors, with the sub-prime crisis causing the global equity markets to lose -38.8% (GBP) over the year. This made it a significant test for our strategy's focus on capital preservation, and it came through it with flying colours: the portfolio actually rose by 2.9% over the year, primarily through its limited exposure to equities and credit and an increased allocation to high-quality bonds at the long end of the curve.

The manager's unerring focus on risk control was also vital. In particular he limited idiosyncratic risk, closely monitored counterparty risk and ensured that the strategy's holdings were highly liquid, which is a vital consideration in any market dislocation.

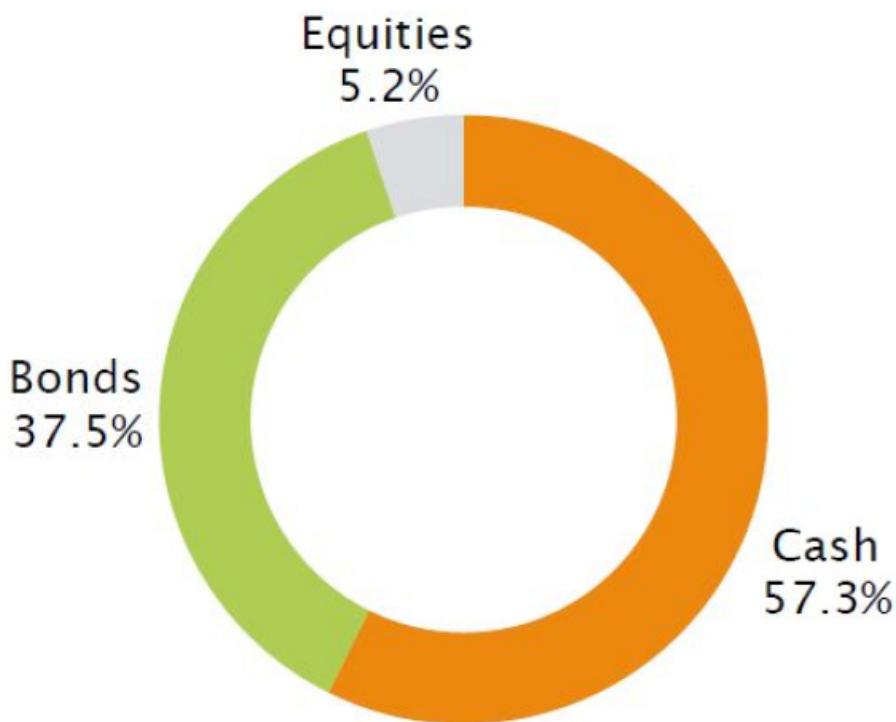
2008 equity market returns



Source

FactSet Research Systems, SYZ Asset Management. Data as at: 1 April 2008 to 31 December 2008

Average fund allocation over 2008



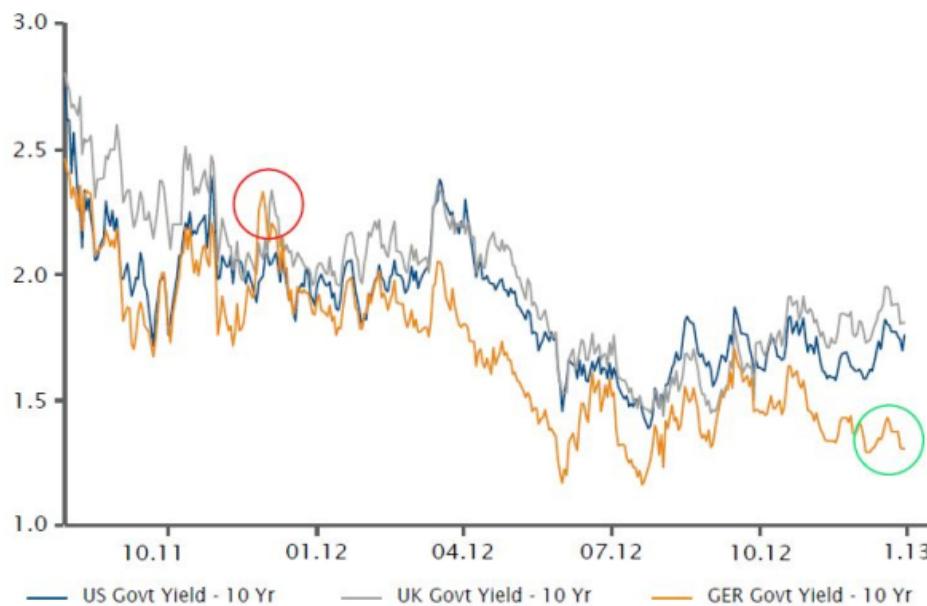
Source

FactSet Research Systems, SYZ Asset Management. Data as at: 1 April 2008 to 31 December 2008

PERFORMANCE IN FOCUS: 2011

2011 was a challenging time for European investors in particular due to the eurozone debt crisis. Despite this, the strategy still rose by 1.6% over the year. This was due to the way we were able to find relative-value opportunities within fixed income and to minimise drawdowns. We only took exposure to European equities through core markets during this period, avoiding the eurozone periphery.

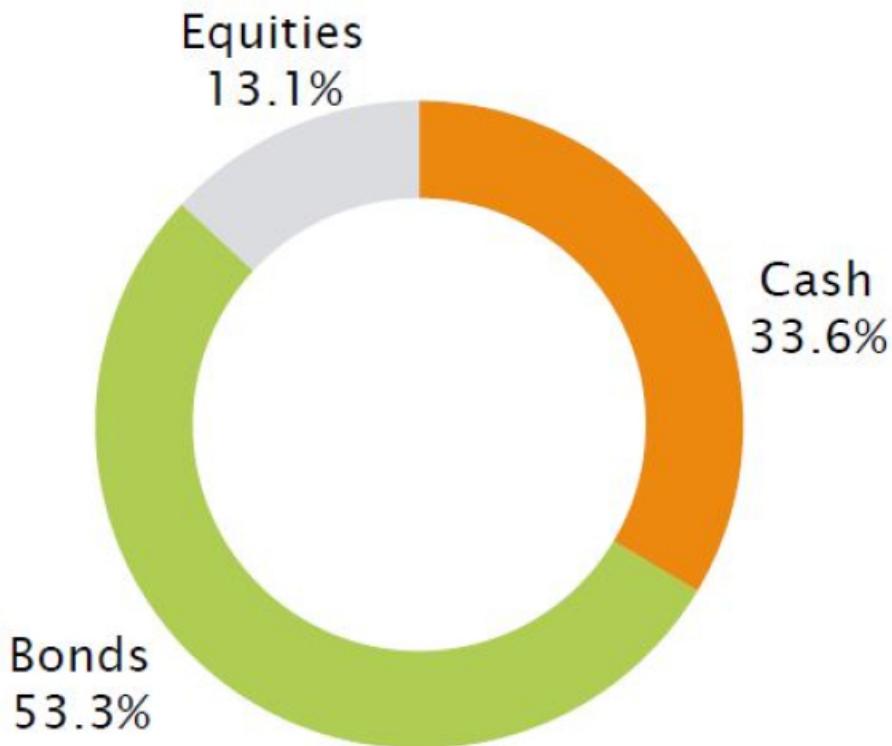
UK, US and German ten-year rates



Source

FactSet Research Systems, SYZ Asset Management. Data as at: 1 September 2011 to 31 January 2013

Average fund allocation over 2011



Source

FactSet Research Systems, SYZ Asset Management. Data as at: 1 January 2011 to 31 December 2011

An investment approach suited for the next 15 years

As we approach the second half of 2018, there are a number of market developments we are watching and considering. These include ECB rate normalisation, inflation, how the current bull market will end, and a new equilibrium in the equity markets that involves applying a lower current multiple to higher earnings.

But the past 15 years have taught us one big lesson: that the markets don't stand still, and that neither can we as an asset manager. We'll continue to apply our flexible approach to the strategy, adapting not just the portfolio's composition in the face of changing markets, but also the way we apply its guidelines and how we exploit the opportunity set available to us. By employing this same philosophy that has served us so well over the past 15 years, we believe we can achieve strong returns in the years ahead: while past performance is not a reliable guide to the future, it's a true measure of what has been achieved so far over a highly dynamic market cycle.

Note: ARI GBP returns shown in sterling unless disclosed otherwise.

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