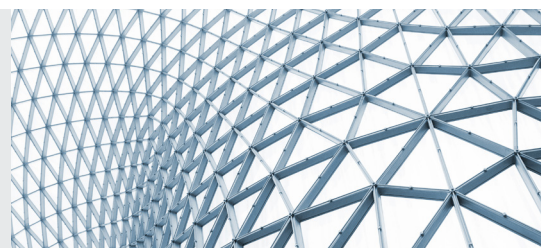


The HUB

NEWS AND VIEWS FOR INSTITUTIONAL INVESTORS



> Find out more:
im.natixis.com/en-institutional

Dynamic risk premia

Exploiting the cyclical nature of investment factors

Key Takeaways:

- Alternative risk premia strategies do not always live up to investors' expectations because back-testing does not always reveal recent underperformance of a factor. Also, many strategies allocate equally to all risk premia, including to factors that have small or negative performance.
- A more rational approach is to start with the premise that risk premia change in value over time and have predictable "cycles." The implication is that risk premia should be dynamically managed.
- A dynamic alternative risk premia strategy has little in common with other forms of investing and almost no correlation with traditional asset classes. It can be tailored to address common client needs, such as absolute return, income, drawdown management and inflation hedging.

Investing in known investment factors has been shown to add value to portfolios. But the academic evidence for investing in factors – or risk premia – does not always conform to investors' experience of it. Outsized paper returns simply may not be available in the real world.

Why? Because the value that can be harvested from risk premia is not permanent. It can get crowded out or decay for other reasons. A passive investment in risk premia can therefore leave a lot of value on the table and expose investors to unnecessary drawdown.

There must be a better way for investors to harness risk premia than through static allocations.

The problem with factor investing

Alternative risk premia, or factor strategies, have been growing in popularity as a complement to both passive and actively-managed portfolios. A key reason for this is that alternative risk premia strategies tend to have low correlations with traditional asset classes so offer investors low-cost diversification. Tried-and-tested alternative risk premia include carry, volatility, value, curve and momentum.

However, alternative risk premia strategies do not always live up to investors' expectations for two principal reasons. First academic research based on back-testing over long time



Harish Sundaresh
Portfolio Manager, Head of
Systematic Strategies
Alpha Strategies Team
Loomis, Sayles & Company



Kevin Kearns
Portfolio Manager, Director
Alpha Strategies Team
Loomis, Sayles & Company



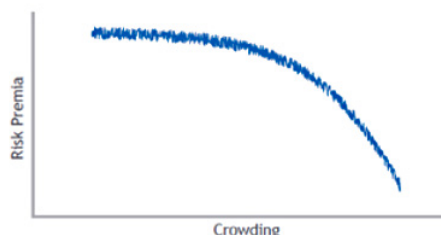
Roger Ackerman
Product Manager
Alpha Strategies Team
Loomis, Sayles & Company

periods does not always reveal recent underperformance of a factor. This underperformance is typically due to the gradual over-crowding of trades in a well-recognised factor.



In US equities, for instance, the value factor earned investors 700bps-900bps annual outperformance 25 years ago. Over the last decade, that outperformance has fallen to just 100bps-200bps, hardly outperformance at all after costs and fees are extracted.

POSITIVE PREMIA, BUT DECAYS OVER TIME WITH CROWDING



Source: Loomis, Sayles & Company

The second significant problem with most alternative risk premia strategies is in portfolio construction: many strategies equally weight all risk premia. Allocating equally to all factors, including factors that have small or negative performance, does not seem the most efficient way to deploy capital. "Why allocate to the value factor in US equities when the trade is so crowded and the potential upside so limited?" asks Harish Sundares, portfolio manager and head of systematic strategies for the Alpha Strategies team at Loomis Sayles, an affiliate of Natixis Investment Managers. The systematic strategies group is responsible for the firm's alternative risk premia efforts.

Towards dynamic portfolios

A more rational approach to factor investing is to start with the premise that risk premia change in value over time and have predictable cycles. A factor that is performing well this year may underperform next year, and vice-versa. The clear implication of this is that risk premia should be dynamically managed.

RISK PREMIA ARE TIME-VARYING AND PREDICTABLE



Source: Loomis, Sayles & Company

Loomis Sayles' dynamic management of risk premia involves placing 25 well-known factors into four categories, or quadrants. Each quadrant represents a phase in the cycle of a risk factor: factors might be in recovery, in a normal state, in expansion or in crisis. The Alpha Strategies team focuses predominantly on identifying the probability that a factor is, or will be, in a crisis state. Machine learning techniques provide forward-looking input by assessing the probabilities of each factor moving into crisis and how the occurrence of a crisis would impact the strategy.

The resulting probabilities are combined with advanced optimization methods to decide weightings to each factor at a point in time. The optimisation process ensures that weightings are dynamic but also that huge, and expensive, swings in allocation do not take place which would reduce returns to investors.

Who's it for?

The strategy can be tailored to address a wide range of client needs, including absolute return, income, drawdown management and inflation hedging.

It has the potential to generate meaningful alpha, meaning it can be regarded as a highly-active, return-seeking component of a portfolio. It can also serve as a bond

It's more than a crisis hedge

Because this dynamic allocation of factors is predicated on assessment of tail risk, it substantially reduces the probability of significant drawdown.

"Even though the strategy is based on risk premia rather than on macro trends, the strategy performs particularly well in times of economic crisis," says Sundares.

It is not a pure crisis hedge, however. The long-term correlation of the strategy to market beta is around -0.1, meaning it can deliver outperformance whatever the prevailing market conditions.

In fact, dynamic alternative risk premia is an active, systematic approach with the potential for differentiated sources of return, which can be additive to all kinds of existing asset exposures.

portfolio substitute given that it has a similar volatility profile to a basket of bonds. In a world of low, even negative rates, it is a viable alternative to a long-only fixed income allocation. Not only does it have low correlation to bonds, but in the potential case of reflation the interest rate risks are significantly lower than for fixed income assets, which could suffer significant losses.

CLIENT NEED

Exposure to absolute return
Exposure to market dislocations
Strong performance during inflationary regimes
Balanced approach to Multi-Asset
Income
DC Plans
Tax Efficiency

SOLUTION

Market neutral Multi-Asset Risk Premia strategies
Opportunistic value suite
Inflation hedge suite
Risk-parity / regime-based solution
Risk premia strategies dominated by carry/dividend factors
Target-date series
Loss-harvesting specific portfolio construction based on tax brackets

Some investors view the strategy as a core holding, providing broad market exposure – through its exposure to many different assets and factors – with an alpha and risk-control focus. Equally it can be a standalone diversifier that aims to minimize volatility or drawdown.

The ability to tailor the strategy to target a level of risk, to reduce drawdown or to hedge inflation, has attracted investors including insurers, banks, pension funds, endowments and high-net-worth individuals.



A strong creative streak

The creation and ongoing evolution of the strategy is based on leveraging the creative talents of the 22 members of the Alpha Strategy team, whose expertise spans across a wide variety of disciplines “Experience is important, but we place equal importance on creativity and have assembled a team of inventive problem solvers who have helped develop something truly differentiated in the market,” says Kevin Kearns, portfolio manager and director of the Alpha Strategies Team.

The Alpha Strategies team employs PhDs in innovative quantitative disciplines

such as optimisation, machine learning and simulation, and matches them to experienced portfolio managers and analysts with asset class expertise and financial experience.

The critical element in developing the strategy was being ultra conservative about over-fitting. In other words, the strategy must work in the real world, not just in theory.

Conclusion: putting it another way

For investors, a dynamic alternative risk premia strategy is a radically different, and more efficient, way of adding alpha

to a portfolio. Performance is generated from allocations to factors depending on the prevailing regime for each of those factors. The strategy has little in common with other forms of investing and almost no correlation with traditional asset classes.

The identification of tail-risk probability, the unique portfolio construction and the exposure to all risk premia, give the strategy the best chance of capturing alpha across cycles and also allow it to be tailored to investors’ needs.

Written on 25 October 2019

The HUB

NEWS AND VIEWS FOR INSTITUTIONAL INVESTORS



ADDITIONAL NOTES

This material has been provided for information purposes only to investment service providers or other Professional Clients, Qualified or Institutional Investors and, when required by local regulation, only at their written request. This material must not be used with Retail Investors. **In the E.U. (outside of the UK and France):** Provided by Natixis Investment Managers S.A. or one of its branch offices listed below. Natixis Investment Managers S.A. is a Luxembourg management company that is authorized by the Commission de Surveillance du Secteur Financier and is incorporated under Luxembourg laws and registered under n. B 115843. Registered office of Natixis Investment Managers S.A.: 2, rue Jean Monnet, L-2180 Luxembourg, Grand Duchy of Luxembourg. **Italy:** Natixis Investment Managers S.A., Succursale Italiana (Bank of Italy Register of Italian Asset Management Companies no 23458.3). Registered office: Via San Clemente 1, 20122 Milan, Italy. **Germany:** Natixis Investment Managers S.A., Zweigniederlassung Deutschland (Registration number: HRB 88541). Registered office: Im Trutz Frankfurt 55, Westend Carrée, 7. Floor, Frankfurt am Main 60322, Germany. **Netherlands:** Natixis Investment Managers, Netherlands (Registration number 50774670). Registered office: Stadsplateau 7, 3521AZ Utrecht, the Netherlands. **Sweden:** Natixis Investment Managers, Nordics Filial (Registration number 516405-9601 - Swedish Companies Registration Office). Registered office: Kungsgatan 48 5tr, Stockholm 111 35, Sweden. **Spain:** Natixis Investment Managers, Sucursal en España. Serrano nº90, 6th Floor, 28006, Madrid, Spain. **In France:** Provided by Natixis Investment Managers International – a portfolio management company authorized by the Autorité des Marchés Financiers (French Financial Markets Authority - AMF) under no. GP 90-009, and a public limited company (société anonyme) registered in the Paris Trade and Companies Register under no. 329 450 738. Registered office: 43 avenue Pierre Mendès France, 75013 Paris. **In Switzerland:** Provided for information purposes only by Natixis Investment Managers, Switzerland Sàrl, Rue du Vieux Collège 10, 1204 Geneva, Switzerland or its representative office in Zurich, Schweizergasse 6, 8001 Zürich. **In the British Isles:** Provided by Natixis Investment Managers UK Limited which is authorised and regulated by the UK Financial Conduct Authority (register no. 190258) - registered office: Natixis Investment Managers UK Limited, One Carter Lane, London, EC4V 5ER. When permitted, the distribution of this material is intended to be made to persons as described as follows: **in the United Kingdom:** this material is intended to be communicated to and/or directed at investment professionals and professional investors only; **in Ireland:** this material is intended to be communicated to and/or directed at professional investors only; **in Guernsey:** this material is intended to be communicated to and/or directed at only financial services providers which hold a license from the Guernsey Financial Services Commission; **in Jersey:** this material is intended to be communicated to and/or directed at professional investors only; **in the Isle of Man:** this material is intended to be communicated to and/or directed at only financial services providers which hold a license from the Isle of Man Financial Services Authority or insurers authorised under section 8 of the Insurance Act 2008. **In the DIFC:** Provided in and from the DIFC financial district by Natixis Investment Managers Middle East (DIFC Branch) which is regulated by the DFSA. Related financial products or services are only available to persons who have sufficient financial experience and understanding to participate in financial markets within the DIFC, and qualify as Professional Clients or Market Counterparties as defined by the DFSA. No other Person should act upon this material. Registered office: Office 603 - Level 6, Currency House Tower 2, PO Box 118257, DIFC, Dubai, United Arab Emirates. **In Japan:** Provided by Natixis Investment Managers Japan Co., Ltd., Registration No.: Director-General of the Kanto Local Financial Bureau (kinsho) No. 425. Content of Business: The Company conducts discretionary asset management business and investment advisory and agency business as a Financial Instruments Business Operator. Registered address: 1-4-5, Roppongi, Minato-ku, Tokyo. **In Taiwan:** Provided by Natixis Investment Managers Securities Investment Consulting (Taipei) Co., Ltd., a Securities Investment Consulting Enterprise regulated by the Financial Supervisory Commission of the R.O.C. Registered address: 34F., No. 68, Sec. 5, Zhongxiao East Road, Xinyi Dist., Taipei City 11065, Taiwan (R.O.C.), license number 2018 FSC SICE No. 024, Tel. +886 2 8789 2788. **In Singapore:** Provided by Natixis Investment Managers Singapore (name registration no. 53102724D) to distributors and institutional investors for informational purposes only. Natixis Investment Managers Singapore is a division of Ostrum Asset Management Asia Limited (company registration no. 199801044D). Registered address of Natixis Investment Managers Singapore: 5 Shenton Way, #22-05 UIC Building, Singapore 068808. **In Hong Kong:** Provided by Natixis Investment Managers Hong Kong Limited to institutional/ corporate professional investors only. **In Australia:** Provided by Natixis Investment Managers Australia Pty Limited (ABN 60 088 786 289) (AFSL No. 246830) and is intended for the general information of financial advisers and wholesale clients only. **In New Zealand:** This document is intended for the general information of New Zealand wholesale investors only and does not constitute financial advice. This is not a regulated offer for the purposes of the Financial Markets Conduct Act 2013 (FMCA) and is only available to New Zealand investors who have certified that they meet the requirements in the FMCA for wholesale investors. Natixis Investment Managers Australia Pty Limited is not a registered financial service provider in New Zealand. **In Latin America:** Provided by Natixis Investment Managers S.A. **In Uruguay:** Provided by Natixis Investment Managers Uruguay S.A., a duly registered investment advisor, authorised and supervised by the Central Bank of Uruguay. Office: San Lucar 1491, oficina 102B, Montevideo, Uruguay, CP 11500. The sale or offer of any units of a fund qualifies as a private placement pursuant to section 2 of Uruguayan law 18,627. **In Colombia:** Provided by Natixis Investment Managers S.A. Oficina de Representación (Colombia) to professional clients for informational purposes only as permitted under Decree 2555 of 2010. Any products, services or investments referred to herein are rendered exclusively outside of Colombia. This material does not constitute a public offering in Colombia and is addressed to less than 100 specifically identified investors. **In Mexico:** Provided by Natixis IM Mexico, S. de R.L. de C.V., which is not a regulated financial entity, securities intermediary, or an investment manager in terms of the Mexican Securities Market Law (Ley del Mercado de Valores) and is not registered with the Comisión Nacional Bancaria y de Valores (CNBV) or any other Mexican authority. Any products, services or investments referred to herein that require authorization or license are rendered exclusively outside of Mexico. While shares of certain ETFs may be listed in the Sistema Internacional de Cotizaciones (SIC), such listing does not represent a public offering of securities in Mexico, and therefore the accuracy of this information has not been confirmed by the CNBV. Natixis Investment Managers is an entity organized under the laws of France and is not authorized by or registered with the CNBV or any other Mexican authority. Any reference contained herein to "Investment Managers" is made to Natixis Investment Managers and/or any of its investment management subsidiaries, which are also not authorized by or registered with the CNBV or any other Mexican authority.

The above referenced entities are business development units of Natixis Investment Managers, the holding company of a diverse line-up of specialised investment management and distribution entities worldwide. The investment management subsidiaries of Natixis Investment Managers conduct any regulated activities only in and from the jurisdictions in which they are licensed or authorized. Their services and the products they manage are not available to all investors in all jurisdictions. It is the responsibility of each investment service provider to ensure that the offering or sale of fund shares or third party investment services to its clients complies with the relevant national law. The provision of this material and/or reference to specific securities, sectors, or markets within this material does not constitute investment advice, or a recommendation or an offer to buy or to sell any security, or an offer of any regulated financial activity. Investors should consider the investment objectives, risks and expenses of any investment carefully before investing. The analyses, opinions, and certain of the investment themes and processes referenced herein represent the views of the portfolio manager(s) as of the date indicated. These, as well as the portfolio holdings and characteristics shown, are subject to change. There can be no assurance that developments will transpire as may be forecasted in this material. Past performance information presented is not indicative of future performance.

Although Natixis Investment Managers believes the information provided in this material to be reliable, including that from third party sources, it does not guarantee the accuracy, adequacy, or completeness of such information. This material may not be distributed, published, or reproduced, in whole or in part.

All amounts shown are expressed in USD unless otherwise indicated.

Loomis, Sayles & Company, L.P.

A subsidiary of Natixis Investment Managers
Investment adviser registered with the U.S. Securities and Exchange Commission
(IARD No. 105377)
One Financial Center,
Boston, MA 02111, USA
www.loomisayles.com

Natixis Investment Managers

RCS Paris 453 952 681
Share Capital: €178 251 690
43 avenue Pierre Mendès-France
75013 Paris
www.im.natixis.com

INT04-0120

MARKET INSIGHTS

DOCUMENT INTENDED EXCLUSIVELY FOR PROFESSIONAL CLIENTS (IN ACCORDANCE WITH MIFID)