

Smoothing the road to recovery

As investors seek to reallocate their portfolios for a post pandemic world – one where corrections and reversals seem to have become increasingly violent and equity markets seem driven by endless amounts of liquidity that has been injected into the global financial system - It is understandable that many are considering equity strategies that are a little more atypical. Low volatility strategies are seemingly gaining in popularity thanks to their potential to limit some of the sharp swings in equity portfolios and out-perform when held throughout the full market cycle. What’s more, this might just allow investors to sleep a little easier during the next market correction.

Nicolas Just, Deputy CEO and CIO at Seeyond, an affiliate of Natixis Investment Managers, explains why ‘low-vol’ strategies can outperform the market and what it can bring to investors.



Nicolas Just
Deputy CEO, CIO
Seeyond

Seeyond Europe Min Vol In a nutshell

- **Asset class:** 100% Equity
- **Type:** Single UCITS fund
- **Style:** Minimum Volatility
- **Scope:** European Equities
- **Strategy:** High active share (70%-90% for previous three years), low-beta, reduced volatility and improved diversification
- **Launched:** September 2010
- **Indicative volatility reduction target:** 30%-40% vs. reference index* (MSCI Europe Net Total Return EUR Index).
- **Portfolio Allocation:** Complements momentum and value strategies in a diversified portfolio
- **Portfolio managers:** Juan Sebastian Caicedo and Nicolas Just

Why has low volatility investing emerged as an increasingly attractive strategy for investors?

In the past few years, it seems the market structure has dramatically changed with the greater integration of global markets and the rise of high-frequency trading, provoking recurrent fast and sharp corrections in an otherwise uptrend market. It seems as though these corrections are becoming more frequent and they happen violently without any early warning sign – and as such, render market timing of fund allocation between different strategies nearly impossible.

In 1987 and 2008 for example, it took between 40 and 45 days for the S&P 500 to fall 30% from its high. In comparison, 2020 was very different, as a similar correction didn’t even take half that time [see figure 1, page 2]. A volatility spike occurred almost without warning, like lightning in a clear blue sky. The reality is that some of the recent corrections have occurred extremely quickly and the reversals have often been equally sharp. This can cause investors not only to majorly suffer the correction, sometimes exit the market at the worst time, and be underexposed in a sharp reversal. To minimize this phenomenon, our minimum volatility strategy aims at outperforming during market downturns, and still being positioned to benefit from market rallies.

Main risks of Seeyond MinVol strategies: capital loss, equity securities, small and mid capitalization companies, exchange rates, geographic and portfolio concentration, financial derivatives instruments, counterparty, changes in laws and/or tax regimes.. Please refer to the full prospectus on im.natixis.com for additional details on risks.

“ *It’s true that financial theory usually states that higher returns require taking higher risk...Actually this dogma can be wrong. Studies show that low volatility stocks tend to generate higher returns than high-risk stocks over the long term.* ”

*The Sub-Fund is actively managed. For indicative purposes only, the Sub-Fund’s performance may be compared to the Reference index. However, it does not aim to replicate that Reference index and may therefore significantly deviate from it.

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But surely lower volatility means lower-risk, which means lower return?

Financial theory often states that higher returns require higher risk...Actually this dogma can be wrong: studies show that low volatility stocks tend to generate higher returns than high-risk stocks over the long term. This phenomenon is called the “Low Volatility anomaly”¹.

The 2008 crisis reinforced our conviction that portfolio construction needs to be considered from a different angle.

With our minimum volatility strategy, we aim to replicate the phenomenon by managing the overall level of portfolio volatility and seeking to enhance risk-adjusted returns. That is why we launched in 2010 a pure approach to minimum volatility: fully invested in equities, benchmark agnostic and unconstrained in terms of sector, country and market cap to maximize diversification opportunities across the portfolio. Our proprietary models help the portfolio managers objectively analyse risks and avoid the pitfalls of fundamental analysis and return expectations as described in behavioural finance studies: overconfidence, herd behaviour, and lottery bias, for example.

“ We want to keep the portfolio’s volatility to a minimum, but the key word is to offer attractive risk-adjusted returns. Beyond trying to minimize the impacts of drawdowns, we also want to participate in equity market rallies. ”

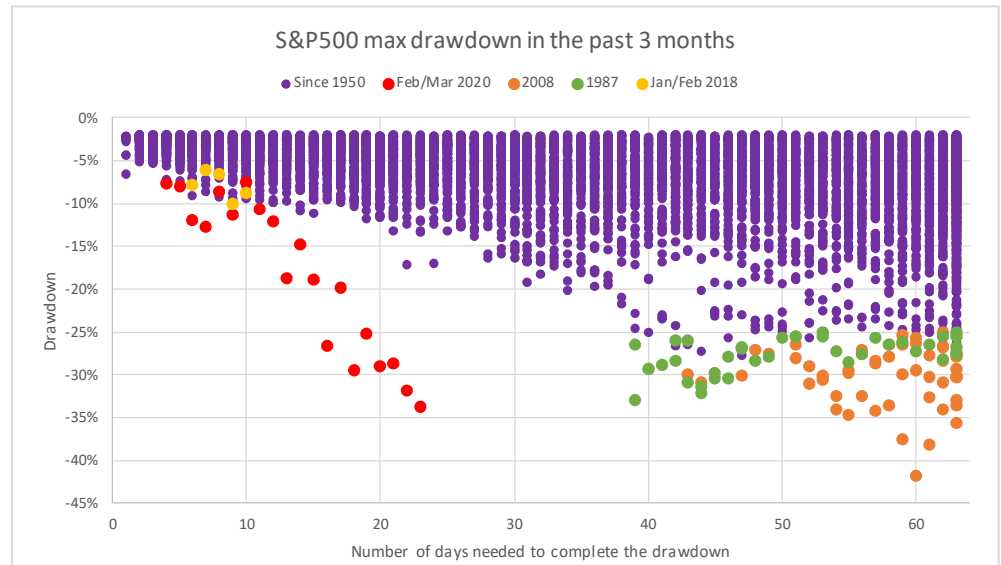


Figure 1: In 1987 and 2008, the S&P 500 took between 40 and 45 days to fall 30% from its high. 2020 was very different to 2008, it took less than half that time.

Source: Seeyond, Bloomberg, as at 31/03/2020

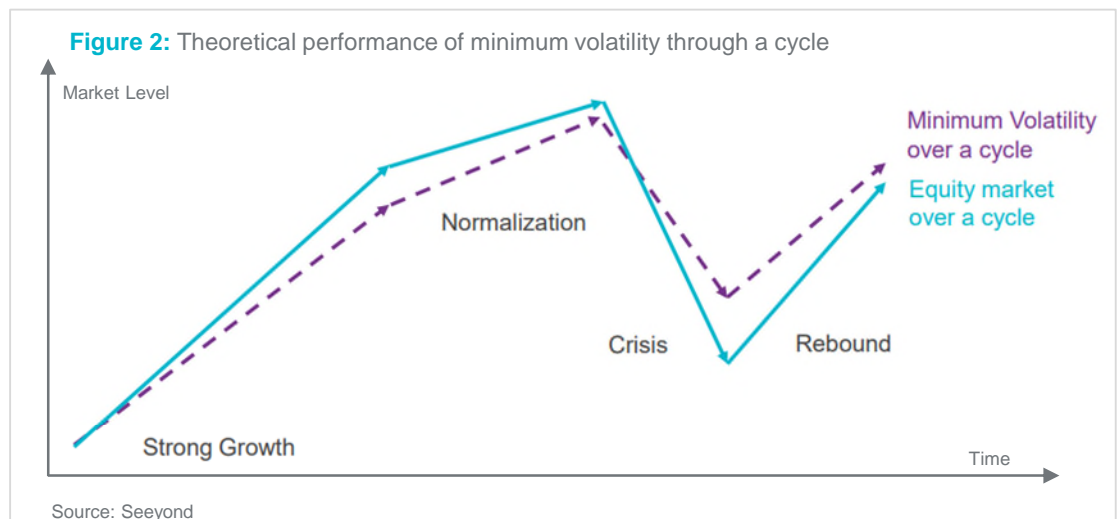
Minimising risk is one thing, but how do you prioritise returns too?

It is true that we want to keep the portfolio’s volatility to a minimum, but the key word is to offer attractive risk-adjusted returns. Beyond trying to minimize the impacts of drawdowns, we also want to participate in equity market rallies.

To reach this dual objective, we aim to build a robust portfolio over the long term. As such, we monitor a broad array of risks such as liquidity and factor exposure and try to avoid hidden risks such as concentration. That is why our approach is unconstrained and why we actively monitor exposures to help ensure efficient diversification.

How can these strategies complement a diversified portfolio?

Minimum Volatility strategies should be considered as a core part of investors’ allocation. Primarily, we believe they marry well with traditional stock picking strategies based on fundamental analysis; with the aim to provide improved diversification and reduce the overall volatility of an equity exposure. Furthermore, with its less volatile and asymmetric risk-return profile, they can be also well suited for investors with less appetite to risk. However, they remain pure equity investments subject to capital loss. As such, investors should always consider how these strategies fit into their wider portfolio and look at the appropriate allocation based on a consideration of their objectives.



Source: Seeyond

¹Source: Seeyond / Bloomberg, 31 December 2018. Studies were conducted on past performance and are no guarantee of, and not necessarily indicative of, future results.

Fund risks & characteristics

Reference index*: MSCI Europe Net Total Return EUR Index

Delegated Investment Manager: Seeyond

Management Company: Natixis Investment Managers International

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