Interview with Alain Groshens, CEO at SystematicEdge

Alain Groshens is the co-founder, CEO, Head of Portfolio Management and Responsible Officer at SystematicEdge. For the past 25 years, Alain has been directly in charge of multi-asset portfolio management and head of trading divisions for major European Investment Banks (Societe Generale, Commerzbank & Natixis), accountable for generating returns and managing risks. As Global Head of Trading, Alain was in charge of 50 traders across the globe, managing multi-asset portfolios totalling up to 30 billion euros of notional. Alain spent most of his career in Asia and was based in Paris, London, Tokyo and Hong Kong.

SystematicEdge is an investment manager that specialises in systematic, multi-asset class portfolio management. They have designed a flagship global macro strategy, which they call 'Global Market Income' and they also provide bespoke systematic managed futures solutions. Through the unique combination of their proprietary strategy (GMI), methodology (Alt-B2G) and portfolio implementation techniques, SystematicEdge has been able to deliver its objective of double digit annualised returns with single digit volatility while preserving capital.

SystematicEdge was founded because they saw a gap in the market for professional and institutional investors who were looking for what they were, safety, transparency and performance, with greater ease of access to sophisticated, institutional level investment solutions. They believe financial services are at an inflection point where traditional asset & wealth management need to incorporate investment banking and hedge fund management techniques as well as the latest technology in order to fully benefit the end investor. As such, they are focused on leveraging new technologies, coupled with Quantitative Research to offer compelling investment solutions while compressing costs. All SFC regulated activity is conducted by Privium Fund Management Limited, Suite 12, Level 5, Champion Tower, 3 Garden Road, Central, Hong Kong, SFC Licence No. BGR298.

1. Please share with our readers a bit of background to the SystematicEdge GMI strategy.

GMI is a systematic Global Macro strategy. The GMI evolutive strategy has been designed during the aftermath of the 2008 crisis and is continuously adapted and enhanced. It is designed to deliver double digit returns with single digit volatility and capital preservation within the new global market paradigm of uncertain economic growth, asset volatility and high impact geopolitical events. Four points define the strategy and illustrate how our systematic process is different from others.

1. Objectives: Double Digit Annualised returns with single digit volatility

2. Multi-Asset-Class investment universe: The portfolio is primarily invested in Equity and Bond benchmarks with opportunistic exposures to Commodity and Currencies which gives investors access to the widest 'opportunity set' for harvesting returns.

3. Systematic Investment Approach: The allocation's rules are based on three fundamental factors: 'Value', 'Quality' and 'Carry'. The strategy is forward looking, based on live fundamental market data (e.g. GDP growth, inflation, interest rates, earnings per share). It is not based on past historical data series calibration or back-testing. Thanks to this forward looking methodology, the process continuously adapts to changing market cycles. What does this mean for the investor: These clear investment rules are designed to produce positive returns that are repeatable and persistent over time.

4. Risk Management: The portfolio downside risk is explicitly mitigated by managing a macro hedge comprising put options (insurances) for a total notional amount equivalent to 100% of the Net Asset Value of the portfolio. What does it mean for the investor: Mitigating the downside risk of the portfolio preserves the compounding effect of the portfolio's returns and its liquidity.

2. Walk us through the team's portfolio construction and investment process. How do they utilise the alternative-beta approach to maintain the fund's edge over other hedge funds implementing a similar strategy?

The GMI systematic fundamental investment process is summarised by saying that: We invest in 'quality' assets that have compelling 'value' and 'carry' potential. Our primary objective is capital preservation. GMI generates sustainable returns primarily from asset income and secondly from capital appreciation.

The investment process consists of four phases:
Phase 1 - Systematic investment framework definition
Phase 2 - Asset grading (with respect to chosen investment factors)
Phase 3 - Asset allocation & portfolio optimisation
Phase 4 - Implementation & execution

3. What are the strategy's edges over other hedge funds implementing a similar strategy?

We define our primary edges in the below four points:

1. Our investment process is systematic fundamental
    - Only based on live fundamental and market data that are continuously read from data providers: i.e it is forward looking, not based or calibrated on past data series
    - The investment process is dynamic and allows the portfolio to adapt to changing market cycles and risk regimes

2. The GMI strategy is greatly scalable as it is only invested in liquid listed assets.

3. Proprietary Technology:
    - "D-SIDE" (Digital Systematic Investment Decision Engine) is our proprietary software application that runs our strategy following our methodology.

4. Cost compression at all levels of the investment process.

However, there are other important aspects of the strategy that differentiate it from its competitors:

1. Our experience: We have decades of experience working on investment solutions with institutional investors such as pension funds, insurance companies, family offices and asset managers.

2. Proven Risk Management expertise: To achieve Capital Preservation within the GMI risk budget, we implemented a Macro Hedge where the methodology has been designed by us, implemented and validated by institutional investors during and following the 2008 financial crisis.

3. Our multi-factor portfolio model: We seek to optimise a 'natural' combination of investment factors: e.g. Value, Quality and Carry. In our experience some factor combinations can result in an 'unstable equilibrium'. However, what we call 'natural combinations' tend to lead to a 'stable equilibrium' such as Value, Quality and Carry and deliver sustainable risk adjusted returns.

4. How can alternative beta contribute to enhance the portfolio's risk-adjusted performance? What are the challenges and how do you overcome them?

If a portfolio manager incorporates a basket of diversified Alternative Risk Premia (e.g. based on Value, Carry, Quality factors) in the portfolio they can enhance the portfolio's risk adjusted profile. Research shows the value added by the ARPs (increase of returns) and their diversifying power (decrease of the portfolio's volatility). Subsequently, it enhances the Sharpe ratio and even reduces drawdowns. Yet portfolios that are **ONLY** comprised of ARPs produce excess returns that are modest compared to the market volatility and there may be a multi-year investment horizon for statistical realisation. "To capture Alternative Risk Premia is like trying to feel a gentle breeze in a raging storm". This phrase from Riccardo Rebonato (quantitative researcher) highlights the behaviour of ARPs.

Therefore, at SystematicEdge, we find that integrating ARPs into a **diversified strategy within a risk management framework produces** more robust and controllable risk adjusted returns than a strategy only comprising ARPs in the academic sense.

Integrating ARPs as a component of a diversified hedge fund strategy leads to:
- Higher return potential as opportunities can be systematically taken via direct, long or short beta exposure (still based on the chosen factors)

- Straight forward "asset" allocation implementation (rather than an allocation of risk premia).
- Scalability (easier to scale or leverage assets than risk premia)
- Ability to implement a hedging strategy framed by the risk budget

5. How do you identify the return drivers of the strategy between Alternative Risk Premia, and your "Alpha"?

Alpha can be generated at all levels of the investment process and is accretive to the systematic returns generated from the ARPs. Therefore, alpha can be generated in:

1. Portfolio construction
2. Portfolio optimisation process
3. The Risk Management process
4. The ability to optimise costs
5. The use of Financial Technology: Fintech gives us the tools enabling the Portfolio Manager to harvest broader return sources based on a large amount of data. The alpha resides in how to apply this technology to achieve the investment goals.

6. What is your approach to provide downside protection in market downturns?

The Risk Management of the portfolio is integral to the strategy. The portfolio downside risk is explicitly mitigated by managing a macro-hedge for a target notional amount equivalent to 100% of the Net Asset Value of the portfolio. The concepts I use have been honed over my decades of experience managing portfolios through different crises, including in 1997, 2001 and of course 2008. During 2008, I was managing a 30 billion US$ portfolio of distressed derivative assets where we needed to protect the downside through the highly dislocated markets of the "Great Financial Crisis".

7. What is the targeted capacity for your strategy and how will the strategy adapt its exposures across the various risk factors to meet its targeted returns?

The strategy has been designed to be very scalable. GMI's investment universe comprises the 150 most liquid listed benchmarks and indices in the world across asset-classes, regions and sectors. We have found that up to US$3 Billion of AUM the strategy's risk adjusted return and behaviour will not be impacted.

The strategy adapts its exposure to meet its targeted returns at the:

a. Global Macro level: Where it updates global-macro parameters impacting all assets.
b. Micro Level for each asset
c. Portfolio optimisation level

8. The concept of alternative beta approach is still relatively new to the alternative investment world. Does the lack of extensive historical data pose difficulties for the team in the portfolio construction and optimisation processes?

To answer the first part of your question, let me highlight a very important differentiating factor about our investment process: it is a fundamental systematic global macro strategy which means that it is:

- Only based on live fundamental and market data: i.e. forward looking, not based or calibrated on past data series. Therefore, although we are using factors that have been in use over decades, our strategy does not depend on past data series.

This is an essential point, as our investment process is dynamic and allows the portfolio to continuously adapt to changing market cycles and risk regimes

9. How is the strategy likely to perform, should it face a period of extreme market distress such as the global financial crisis of 2008?

In volatile markets: The accumulation of Carry and Value premiums continues but with more volatile asset prices. The GMI systematic investment process is continuously accumulating:

1. Carry premiums: e.g. dividends, credit yields, high interest rates.

2. Value premiums: the portfolio is continuously rebalanced in order take profit on expensive assets and invest in cheaper ones.

10. How has the market for alternative beta-based hedge fund strategies grown over the past few years, and what are your expectations on the market developments over the upcoming years?

New investment money flow of AUM in Alt-β related strategies is projected to rise from around US$275 billion in 2017 to more than US$1 trillion by the end of 2019 (according to several institutional and prime broker surveys) The AUM in systematic diversified strategies such as Alt-β, is continuously increasing while the AUM in discretionary strategies is decreasing. Most likely because investors understand that clear investment rules are designed to produce positive returns that are repeatable and persistent over time.

11. What type of investors do you currently cater to and why are they interested in your strategy?

Our investors are Institutional and Professional asset owners and asset managers. They are interested in our strategy because it has: compelling risk adjusted returns and is liquid and transparent. In addition, the strategy can be accessed through multiple vehicles including a managed account format (either Interactive Brokers or their own provider). This is very compelling for many investors, especially since 2008, as they value keeping ownership of their assets managed in their account, in a strategy that is liquid. For example within the HNW professional investor category, we have clients that are "regulated persons" meaning they work for financial institutions, as I used to, and as such cannot manage their money on their own. They come to us, because they are looking for compelling risk adjusted returns. They like our managed account offering, which allows them to keep their assets in their brokerage account, while being exposed to our GMI flagship strategy. In addition, this solution meets their employer's internal regulatory requirements. As another illustration, family offices, are often looking for a solution with an absolute return objective because they must manage the families' ALM requirements that has known absolute costs and liabilities.

12. How does your solution fit within an investor's portfolio of traditional and alternative investments and how can it complement the existing investments by offering something distinct which would improve the overall portfolio performance?

For our 'systematic global macro' strategy, there are several main themes that we have heard from investors, which lead them to invest, including:

1. An absolute, risk adjusted return objective
2. A systematic process, that is forward looking, based on live fundamental market data and not based on past historical data series calibration, and which continuously adapts to changing market cycles.
3. Active Risk Management and mitigation of the downside risk
4. Global Diversification across asset classes and regions
5. Transparency, Liquidity, Capacity & Scalability
6. Returns granularity (i.e. clear breakdown of return drivers)
7. Cost and capital efficiency

Therefore our solution fits with investors that are looking for some or all of the above characteristics. We will be happy to provide more insights to professional investors on request.

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