21 July 2023

How do successful funds tick?

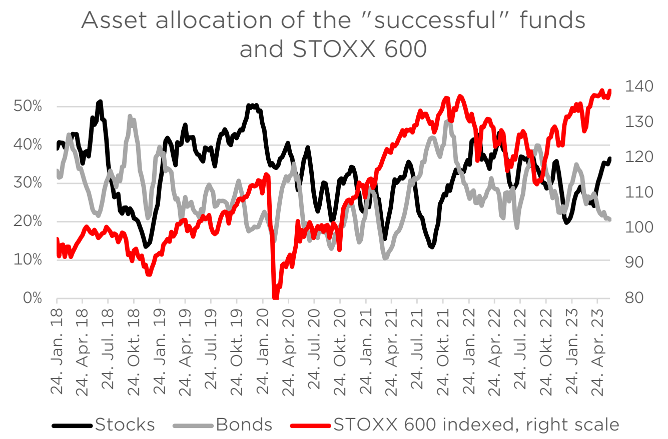
Who wouldn't want to understand what goes on in the minds of successful asset managers? After all, there would be a legitimate hope that insights into their world of thoughts could also be helpful for their own actions and, ideally, improve performance. Unfortunately, the very good asset managers typically do not share their thoughts in real time, and one rarely has timely access to the portfolio positions. Therefore, at this point, one could already bury the tempting consideration and get back to the day-to-day business - if one were not a little stubborn, as we sometimes are. Because even if you don't have real-time data on competitors' portfolio structures, you're not completely in the fog of ignorance when it comes to the positioning of other portfolio managers. That's because every portfolio manager leaves a mark with their decisions, in the form of their generated performance.

Allocation replication

In order to imagine this situation more precisely, one can put oneself in the picture of a ship which has a certain course. Now, it is not possible to look over the shoulder of the captain of a foreign ship, which exact course has just been set. But you could (for example on satellite images) interpolate quite well from the track of the wake, which course seems to be set at the moment. And this is exactly what can be done with price data. The price development of a portfolio or fund does not fall from the sky, but is always the result of an investment in securities. The composition of these securities can be replicated indirectly via a mathematical procedure with a high degree of accuracy. This works as follows: An optimizer is "offered" a number of asset classes and markets with which it must replicate the specific performance of a fund. This replication is subject to certain restrictions; e.g. the sum of the invested assets must not exceed 110%, and the cash ratio must not rise above 30%. Now the task is to match the actual performance of a portfolio as best as possible by explaining the performance of the fund over a period of e.g. 100 trading days as far as possible without deviations by a suitable mix of assets and markets. This actually works extremely well in the vast majority of cases, but is unfortunately comparatively computationally expensive.

Test setup

We did it anyway and proceeded as follows: In a first step, we identified around 2,600 funds that have existed continuously for many years and can be classified as asset management funds. For these funds, we have now determined the respective information ratio every week starting in 2017, which in principle not only shows the outperformance, but also describes how systematically this outperformance is achieved. Each week, we selected the 35 funds that had the best information ratio of all funds at that moment and were therefore representative of the group of particularly good portfolio managers. For these 35 funds, the replication was then calculated in the next step. In other words, the exact mix of asset classes and markets was determined to almost perfectly replicate the performance of the respective fund. Unfortunately, we had to limit ourselves to 35 funds per week at this point, as this step is very computationally intensive, although we would have liked to do this for 200 or 300 good funds per week. But even limiting ourselves to 35 funds resulted in a computing time of several days and crashed the PC several times, which in turn tested our patience. However, the result is highly interesting and compensates for the effort. Because you get statistically secured one or the other insight, which you might have suspected, but could not prove so far.



This shows that in many cases even the successful funds follow the market, at least in the short term; for example, when the stock market falls, the equity ratios in the respective successful funds also often go down (at least over short periods). Rebalancing to a strategic quota therefore does not take place immediately or with high frequency. However, there are a few conspicuous features: it is noticeable that the funds which, for example, had a very good information ratio for the period 2018/2019 (strictly speaking, we always go back exactly 500 trading days in order to determine the information ratio for a fund), already reduced the share quota in the run-up to the Corona crisis. Can this be the case? Is it possible that these funds saw the problem of the approaching pandemic coming as early as late 2019 and early 2020? One cannot quite believe it, but this movement actually raises questions! On the other hand, it is interesting to see that the very good funds in each case did not really trust the subsequent upswing on the stock markets - on trend, the equity ratio falls from the beginning of 2020 to September 2021. It is also interesting to observe that equity and bond ratios are not always negatively correlated with each other, as might be expected under certain circumstances. Although there are always short-term diametric movements, equity and bond ratios are often lowered and cash built up at the same time, as was the case relatively strikingly in the fall of 2018, for example. At this point, it may be worth mentioning that we have of course not only used two indices to represent the equity market and the bond market in the model, but in total more than 20 markets in a wide variety of regions. The stock and bond ratios shown here are therefore always the sum of individual markets.

Is there a recipe for success?

So is there a recipe for success that could be derived from these observations? It's probably not quite that simple. But a few facts do crystallize. On a weekly or monthly basis, for example, there tends to be no anticyclical behavior, although over longer periods it can be seen that fund managers of very good funds sometimes take contrary positions to the trend. However, when there is procyclical behavior over many months (such as April 2018 to April 2019), this procyclical behavior is very extreme. For example, while the broad European stock market did not lose much more than ten percent during this period, the average equity exposure was more than halved, only to double again in a short period of time. In general, it seems that the very good funds act comparatively aggressively - a fact that cannot be taken directly from the chart above.

However, we noticed that the funds with a high information ratio also tended to have a high tracking error compared to the average performance of all asset management funds. In addition, we also noticed that it was precisely the funds with a particularly high information ratio that were less able to be replicated by various common markets. There are two reasons for this: Either the funds in question repeatedly invest in exotic markets. Or, there is single stock selection, which in turn leads to a high tracking error relative to the indices we use. Whatever the case, there is one lesson in any case. If you want to be ahead, you have to be active on many levels. Simply "swimming along" is not enough!

Market data

Stock marktes	As of 21.07.2023 09:39	Change versus 07.07.2023 -1 week	13.06.2023 -1 month	13.04.2023 -3 months	13.07.2022 -1 year	30.12.2022 YTD
Dow Jones	35225	4,4%	3,0%	3,5%	14,5%	6,3%
S&P 500	4574	4,0%	4,7%	10,3%	20,3%	19,1%
Nasdaq	14063	2,9%	3,6%	15,6%	25,0%	34,4%
DAX	16143	3,5%	-0,5%	2,6%	26,6%	15,9%
MDAX	28182	4,3%	2,6%	2,3%	10,5%	12,2%
TecDAX	3189	3,0%	-1,9%	-4,0%	9,0%	9,2%
EuroStoxx 50	4363	3,0%	0,4%	0,0%	26,3%	15,0%
Stoxx 50	3973	3,1%	-0,5%	-1,2%	14,3%	8,8%
SMI (Swiss Market Index)	11193	2,9%	-1,2%	-0,6%	2,6%	4,3%
Nikkei 225	32304	-0,3%	-2,2%	14,7%	22,0%	23,8%
Brasilien BOVESPA	118083	-0,7%	1,1%	10,9%	20,6%	7,6%
Russland RTS	1009	3,4%	-2,1%	2,6%	-10,0%	3,9%
Indien BSE 30	66795	2,3%	5,8%	10,5%	24,8%	9,8%
China CSI 300	3822	-0,1%	-1,1%	-6,1%	-11,6%	-1,3%
MSCI Welt	3030	3,6%	3,4%	7,1%	19,1%	16,4%
MSCI Emerging Markets	1018	3,8%	0,5%	2,1%	4,9%	6,4%
Bond markets						
Bund-Future	133,01	189	-64	-211	-1961	8
Bobl-Future	115,62	77	-72	-198	-1016	-13
Schatz-Future	104,89	13	-43	-68	-474	-53
3 Monats Euribor	3,65	24	50	75	370	176
3M Euribor Future, Dec 2023	3,96	-6	18	34	247	35
3 Monats $ Libor	5,57	1	2	31	306	81
Fed Funds Future, Dec 2023	5,39	-1	22	98	240	75
10 year US Treasuries	3,85	-19	2	40	94	2
10 year Bunds	2,45	-18	2	8	136	-11
10 year JGB	0,45	3	3	4	26	4
10 year Swiss Government	0,96	-11	0	-12	26	-65
US Treas 10Y Performance	596,20	2,5%	0,8%	-1,8%	-3,6%	2,8%
Bund 10Y Performance	538,72	1,5%	-0,1%	-0,2%	-9,0%	2,5%
REX Performance Index	433,87	1,3%	-0,4%	-0,4%	-6,3%	0,3%
IBOXX AA, €	3,69	-18	3	13	143	10
IBOXX BBB, €	4,55	-20	1	6	107	-14
ML US High Yield	8,37	-42	-22	-3	-25	-61
Convertible Bonds, Exane 25	6620	0,0%	0,0%	0,0%	5,2%	0,0%
Commodities						
MG Base Metal Index	383,89	1,4%	-0,8%	-7,4%	3,3%	-8,2%
Crude oil Brent	80,39	2,3%	8,2%	-6,6%	-19,6%	-5,3%
Gold	1967,49	2,0%	0,9%	-3,4%	12,8%	8,4%
Silver	24,59	6,6%	3,4%	-4,7%	27,7%	3,5%
Aluminium	2237,25	6,5%	2,0%	-4,0%	-4,6%	-4,8%
Copper	8687,00	3,9%	2,8%	-4,2%	18,8%	3,9%
Iron ore	112,43	1,7%	0,0%	-6,2%	1,2%	1,0%
Freight rates Baltic Dry Index	977	-3,2%	-9,0%	-33,2%	-51,2%	-35,5%
Currencies						
EUR/ USD	1,1132	2,2%	3,1%	1,1%	10,6%	4,4%
EUR/ GBP	0,8641	1,2%	0,8%	-2,2%	2,1%	-2,6%
EUR/ JPY	156,92	0,6%	4,2%	6,9%	13,7%	11,6%
EUR/ CHF	0,9641	-1,2%	-1,5%	-1,7%	-1,9%	-2,1%
USD/ CNY	7,1735	-0,7%	0,2%	4,4%	6,7%	3,9%
USD/ JPY	138,05	-2,8%	-1,5%	4,1%	0,4%	5,3%
USD/ GBP	0,78	-0,4%	-2,1%	-2,9%	-7,2%	-6,6%

Source: Refinitiv Datastream

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