

A systematic approach to global macro



✔ **CFM's head of quantitative investment solutions, Philip Seager, talks to *Pensions Age* about the diversification benefits of systematic global macro for pension portfolios**

What is the current investment climate and how should investors adapt to this?

Central banks and policymakers have reacted quickly to the Covid crisis with ultra-loose monetary policy and aggressive fiscal stimulus packages. Once the vaccine covers a large part of the population and consumer spending resumes, one can easily foresee an imminent spike in inflation. This rise will likely be temporary but there are reasons to suggest a more permanent regime could take hold, with people retiring younger and a pullback in globalisation and immigration, all creating a lack of workers. Also, central banks are arguably becoming more comfortable or borderline complacent to inflation risk. Our research finds that over the past 20 years, there is a negative correlation between developed market government bonds and equities. Going back over a century, the bond/equity correlation was positive, so this negative correlation has really been an outlier. We argue that this flip to a negative correlation was a behavioural change as investors became comfortable with central bank easing – meaning when the economy weakened then central bank easing no longer stoked inflation. If rising inflation now pushes the correlation between bonds and equities back to positive, then bonds are no longer an efficient diversifier.

In such a climate how do we most effectively diversify equities? Or even better, hedge?

Investors often confuse diversification with hedging. Diversification means uncorrelated, so if equities go down then your diversifier can either go down with equities or go up. Just because it goes down when equities go down doesn't mean it is not a diversifier. If you want something that goes up when equities go down then you are looking for a hedge. Many macro strategies tend to be a natural diversifier from equities but not many are a real hedge. A genuine hedge strategy is quite rare. In the absence of bonds being a good hedge or even a diversifier what should one do? We have been exploiting trend following (TF) effects since CFM's 1991 creation to generate positive returns. TF is a long-term positively drifting strategy. We believe that this positive performance is due to a behavioural bias where investors 'need' to follow trends, which become self-fulfilling. TF is also a mechanical hedge, just look at the performance of CTAs in 2008! It is the positive drift that makes TF different to buying options though. With buying options you get an equity hedge but it comes at the cost of a negative drift. Taking the right mix of systematic macro and adapted TF strategies and blending with equities, provides both a diversifier and a hedge.

How can this Systematic Global Macro (SGM) programme help with diversification? And how does this differ from discretionary macro?

Macro programmes generally tend to be uncorrelated with equities and also with most other strategies and asset classes. If

they are uncorrelated and have a positive return profile, when blended with traditional portfolios you get improved risk-adjusted returns. SGM takes macro ideas and builds an algorithm to capture that effect in an automated fashion. The skill of the systematic macro manager is to take only those strategies whose performance is not just a statistical fluke. In investment, as in many areas of daily life, algorithms are efficiently used to absorb, treat and analyse vast amounts of data to make decisions. It is our belief that this trend towards automation can only continue and that algorithms will have an increasing advantage over discretionary investors over time.

What benefits can SGM provide for pension fund portfolios?

The good thing about systematic macro is there is always a rationale behind the strategy that can be explained. Pension funds want to have that understanding, transparency and explanation. Pension funds often hold public and private equities, bonds and perhaps some credit, infrastructure, real estate etc. Most of these instruments have some equity exposure or premium embedded in them – so diversification is difficult. Macro-style strategies bring genuine decorrelation and diversification, which will improve risk-adjusted outcomes (if they perform positively). Because bond returns are looking poor and interest rates are at historic lows, with inflation potentially picking up, one can argue that this macro approach can be a good replacement for bonds. This approach, coupled with the transparency and understanding that you can get from SGM, makes it a positive addition to a pension fund portfolio.

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