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FINANCIAL CRISES: HOW CFM NAVIGATES THE MARKETS

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Financial crises: How CFM navigates the markets

Were you nervous on June 24th? A huge number of investors around the world certainly were. When the chairwoman of the United Kingdom Electoral Commission took to the stage and officially declared that the UK had voted to leave the European Union it sent shockwaves throughout global markets.

Over the next two days equity markets had more than $3tn wiped off their value while equity funds suffered outflows of more than $20bn in the week that followed[1]. Coming so soon after unprecedented events like the Chinese stock market crash, the Greek government debt crisis and the global financial crisis it was yet more proof that we live in exceptional times.

At least that's what we're told. That's what we're conditioned to believe.

Figure 1: Brexit: Time to panic?

At CFM we see things differently. It's true that we live in uncertain times and that markets are volatile, but they always have been and they always will be. Brexit is just the latest crisis in a timeline of financial upheaval that stretches back to the Imperial Crisis faced by the Roman Empire in AD 235–284[2].

[1] Data from EPFR Global, July 2016

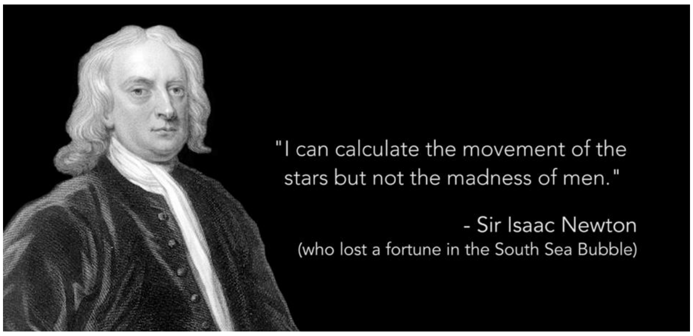

Figure 2: A history of crisis, Sir Isaac Newton, 1720

In fact, according to the IMF, between 1970 and 2011 alone there were 431 financial crises[3]. Each crisis may have a different name, it may start in a different country and involve different financial institutions, but for us the only this that matters is this: crisis is constant. It's a fact of life.

> This time may seem different, but all too often a deeper look shows it is not.
>
> Carmen M. Reinhart & Kenneth S. Rogoff

Are you looking for drama?

For active asset manager's crisis brings drama, which can test the nerves of even the most experienced investors. When a crisis hits active asset managers react. Some even thrive on drama and highlight that this is when they really earn their fees.

But can your fund manager really beat the market and navigate their way out of trouble? Can they analyse market trends, economic data and company specific news to deliver superior performance? More often than not, they can't.

In Europe, for example, the reality is that almost every actively managed equity fund has failed to beat its benchmark over the past decade[4].

[2] https://en.wikipedia.org/List_of_economic_crises
[3] IMF Working Paper, Systematic Banking Crises Database: An Update'. WP/12/163
[4] S&P Global, SPIVA Europe Scorecard

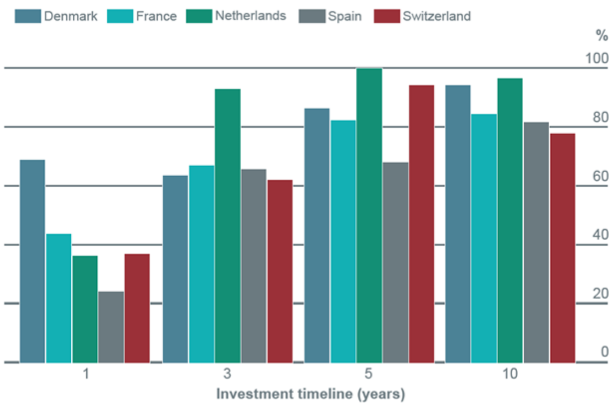

Figure 3: European snapshot: Percentage of active equity funds that failed to beat their benchmark. Source SPIVA (2015).

Our approach is rooted in reality

At CFM we bake crisis into the cake and leave drama at the door. We believe investors should build their portfolios based on facts not conventional wisdom or hunches.

We design portfolios that take crises into account and that seek to be resilient enough to withstand them. It's a passive but systematic approach.

So how does it work? Firstly, research and technology are key to our investment process which involve creating strategies derived from the analysis of industrial quantities of financial data.

Since our inception in 1991, we have invested over €100m in sophisticated IT systems, creating a state of the art platform with enough processing power to collect and access the data required by our research teams and trading systems. Today, more than 1,500 servers power the analysis of 2.5 terabytes of new information, collected on a daily basis, the equivalent of a typical academic research library.

That allows our trading decisions to be executed in a highly systematic and disciplined way. We look for statistically significant patterns from which investment strategies are created, then rigorously tested, before being implemented by algorithms.

Secondly, we create diverse portfolios. We make sure are our portfolios aren't just correlated to rises or falls in the stock markets. This means they are well equipped to handle volatility.

We're in the business of managing risk and we believe that a well-diversified portfolio is the best way to maximise risk adjusted returns.

Alternative beta

When bond yields make diversification increasingly challenging and with investors growing frustrated with high fees and poor performance Alternative Beta strategies provide a solution.

These strategies give exposure to persistent, historical pricing anomalies and seek to generate returns uncorrelated to equity and fixed income beta. Discovering, running and implementing these strategies requires experience developed over decades and significant investment in research and technology. That's what we do at CFM.

Important disclosures

By accepting this document, the recipient acknowledges and agrees that all of the information included in this document should be maintained strictly confidential.

Any description or information involving investment process or allocations is provided for illustrations purposes only.

Any statements regarding correlations or modes or other similar statements constitute only subjective views, are based upon expectations or beliefs, should not be relied on, are subject to change due to a variety of factors, including fluctuating market conditions, and involve inherent risks and uncertainties, both general and specific, many of which cannot be predicted or quantified and are beyond CFM's control. Future evidence and actual results could differ materially from those set forth, contemplated by or underlying these statements. There can be no assurance that these statements are or will prove to be accurate or complete in any way. All figures are unaudited.

CFM has pioneered and applied an academic and scientific approach to financial markets, creating award winning strategies and a market leading investment management firm.

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