Alpha Research & Management

July 2024 – Plus Alpha Model Portfolios - Returns and Newsletter

Plus Alpha: Systematic Active Fixed Income ETF Model Portfolios

Active Model Portfolios & Benchmarks	July 2024	YTD 2024	1-year	3-year	5-Year	ITD 1/2016	Annual Alpha - AGG	Beta-AGG	Corr - AGG	12mo Reward Risk Ratio
BenchMark+	**2.3%**	**4.6%**	**10.4%**	**4.6%**	**16.1%**	**38.5%**	**2.5%**	**1.03**	**0.65**	**1.4**
BenchMark+ IG1	**2.1%**	**2.0%**	**4.7%**	**-5.5%**	**5.0%**	**20.0%**	**0.6%**	**1.07**	**0.92**	**0.5**
Benchmark+ IG2	**2.6%**	**1.4%**	**5.9%**	**-9.2%**	**4.8%**	**24.2%**	**0.5%**	**1.46**	**0.93**	**0.5**
AGG+ Baseline	**1.8%**	**5.5%**	**10.3%**	**9.4%**	**30.3%**	**54.6%**	**4.2%**	**0.71**	**0.60**	**2.1**
AGG+ Aggressive	**1.5%**	**5.7%**	**9.8%**	**1.7%**	**27.4%**	**69.0%**	**4.9%**	**1.05**	**0.62**	**1.8**
AGG+ Inv Grade	**0.0%**	**2.5%**	**7.5%**	**0.6%**	**16.2%**	**30.6%**	**2.2%**	**0.75**	**0.57**	**2.2**
HY+ Baseline	**1.9%**	**4.4%**	**6.9%**	**-4.9%**	**41.0%**	**80.2%**	**5.9%**	**1.03**	**0.52**	**0.8**
HY+ Aggressive	**2.5%**	**2.7%**	**3.9%**	**-15.8%**	**43.3%**	**94.3%**	**7.0%**	**1.19**	**0.45**	**0.3**
Index Returns										
Agg Index	**2.3%**	**1.7%**	**5.1%**	**-7.7%**	**0.9%**	**14.1%**	**0.0%**	**1.00**	**1.00**	**0.2**
U.S. Treasury	2.2%	1.3%	4.1%	-8.7%	-1.0%	8.5%	-0.4%	0.91	0.94	0.2
Govt-Related	2.0%	1.9%	5.3%	-5.0%	2.8%	17.4%	0.6%	0.85	0.96	0.2
Corporate	2.4%	1.9%	6.8%	-7.9%	5.0%	27.7%	1.0%	1.28	0.91	0.2
Securitized	2.6%	1.8%	5.1%	-6.4%	-1.0%	9.2%	-0.4%	0.92	0.95	0.2
MBS	2.6%	1.6%	4.9%	-6.7%	-1.6%	8.3%	-0.5%	0.94	0.94	0.2
High Yield	1.9%	4.6%	11.1%	6.6%	22.9%	67.5%	5.1%	0.78	0.52	0.5

Hello. We've spent the past month conducting new original research on fixed income funds and Fixed Income portfolio construction, to improve our systematic active algorithms. The new active model portfolios, built from over 400 ETFs, offer significant improvements over prior versions.

Benchmark+ and Benchmark+ IG

These active portfolios are constructed from only 9 very liquid scalable benchmark ETFs: AGG, GOVT, MBB, TIP, LQD, HYG, TLT, BIL, IAGG. (The IG versions exclude HYG and IAGG.)

These are examples of the returns that are possible in Fixed Income through systematic Active Management: **positive Alpha, with great liquidity**!

If your Fixed Income provider or team is underperforming these Benchmark portfolios, you might be interested in learning more about what we do, and maybe use some of our model portfolios.

We use these as our references for the minimum acceptable performance of an active construct, and also require improvement in the Risk Reward Ratio ("RRR") (Mean Return/Standard Deviation).

The RRR in each case is better than the RRR of the AGG Index (0.2).

AGG+ Baseline

This is our primary recommended Active model portfolio, targeting the risk of the AGG ETF. It includes ETFs of most asset classes that are used by other 'Active' Fixed Income funds, choosing from over 400 ETFs currently.

By virtue of the high Alpha of 4.2%, the slope of the regression to the benchmark AGG is tilted down, and a Beta 0.7 results, with a high Sharpe ratio, and a low 0.6 correlation. The cumulative return since 2016 is 54.6%, vs the AGG at 13.6%.

The 12mo RRR of 2.1 is much better than the 1.4 RRR of the Benchmark+ portfolio.

AGG+ Aggressive

Using the same ETFs as the Baseline, this model targets a higher level of risk than the AGG in order to increase the Beta. The result: 4.9% Alpha, 1.05 Beta, 0.6 correlation, 69% cumulative return.

AGG+ Investment Grade (IG)

This model portfolio uses ETFs from only IG sectors, matching the strict definition of the Agg Index. This is should be compared to the Benchmark+ IG1 models – it generates 2.2% Alpha vs the 0.6% Alpha that is available from using only the large benchmark ETFs.

HY+ Baseline

This model portfolio targets the risk of the HYG ETF. It generates 5.9% Alpha over the AGG, a Beta of 1.03, with a 0.5 correlation. Versus HYG, the Alpha is 2.41%, 1.07 Beta, 0.7 correlation.

The cumulative return is 80% vs 67.5% for the HY Index.

HY+ Aggressive

This model targets a higher risk than HYG, and generates a commensurately higher return, with an Alpha to the AGG of 7%, a Beta of 1.19, and a low 0.45 correlation. Versus HYG, the Alpha is 2.53, with a 1.3 Beta, and 0.54 correlation.

The cumulative return since 2016 is 94.3% (102.4% gross). The RRR is lower than that of HYG, however, so this portfolio should be used tactically.

None of our model portfolios use any leverage. The Alpha of our portfolios is generated through systematic Active Management, by using the portfolio construction process and algorithms derived from our research.

All the model back-test total returns are 'out-of-sample', after implied fees, after systematic rebalancing creates the following period's portfolio. The only risk to these return numbers come from execution risk. To handicap this, our Fact Sheets display Bloomberg's LQA (Liquidity Analysis) statistics for the current portfolio – this was described in the April 2024 newsletter.

To recap: we target the risk of a benchmark index - the AGG, HYG, etc - and systematically build portfolios of Fixed Income ETFs, and rebalance the portfolios of ETFs periodically to reflect changes in market risk, making this an Active Strategy.

We believe this is the only true Active Fixed Income strategy offered in the market – our research is available in our paper 'Are "Active" Fixed Income Funds Active?'. Quick takeaway – if a fund is truly 'Active', it will have volatile Beta and low correlation with its benchmark.

Our strategy was conceived in 2016 as a result of our research into Behavioral Biases in Fixed Income and Flaws in the Market Structure. **Our systematic solution takes advantage of biases and flaws** in Fixed Income management to realize the potential returns available in Fixed Income, and to capture the attendant benefits to portfolio construction and asset allocation (low correlations, positive skewness, higher Sharpes).

The long-term Alpha is significant. The Risk Targeting algorithms are continuously improved, and the Alpha has been persistent.

Unlike many quant strategies, we expect the Alpha in our Systematic Fixed Income Strategy to remain persistent.

We currently custody at Charles Schwab and Interactive Brokers for our systematic strategies. Some of our models will also be available on Direct Index platforms soon – stand by for announcements.

We are also seeking institutions, wealth managers and TAMPs that might have interest in licensing our customizable Model Portfolios.

Please call with questions.
Regards, Samir

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