Alpha Research & Management

Apr 2024 – ARAM AGG Plus Alpha - Returns and Newsletter

AGG Plus Alpha – Systematic Active Fixed Income ETF Model Portfolios

	Apr24 % Net Return	2024 YTD Net %	1 year Net %	3 year Net %	5 Year Net %	Cum Net % since 1/2016	12mo Trailing Beta to AGG	12mo Trailing Correl to AGG
Baseline: (ModelPort20)	**+0.72%**	**+3.6%**	**+11.9%**	**+6.2%**	**+19.9%**	**+38.5%**	**0.27**	**72%**
Aggressive: (ModelPort55)	**+0.24%**	**+3.1%**	**+10.7%**	**+2.3%**	**+21.1%**	**+53.9%**	**0.33**	**75%**
CoreAGG: (ModelPort91)	**+0.56%**	**+2.8%**	**+11.2%**	**+2.5%**	**+13.5%**	**+25.6%**	**0.24**	**60%**
Diversified: (ModelPort1)	**-0.05%**	**+1.8%**	**+10.1%**	**+2.0%**	**+22.4%**	**+40.4%**	**0.34**	**69%**
Large-Diversified (ModelPort3)	**-0.82%**	**+1.0%**	**+7.6%**	**-0.6%**	**+15.1%**	**+31.0%**	**0.41**	**80%**
AGG ETF	**-2.5%**	**-3.2%**	**-1.5%**	**-10.2%**	**-0.9%**	**+8.1%**	**1.0**	**100%**
U.S. Treasury	-2.3%	-3.3%	-2.8%	-10.8%	-2.5%	3.6%		
Govt-Related	-1.9%	-2.3%	-0.3%	-7.2%	1.5%	12.5%		
Corporate	-2.5%	-2.9%	1.0%	-8.9%	4.5%	21.7%		
Securitized	-2.9%	-3.8%	-1.9%	-11.1%	-4.1%	3.2%		
MBS	-3.0%	-4.0%	-2.2%	-11.5%	-4.8%	2.3%		

Bonds sold off and yields rose in April, with the 10yr off by almost 4%, and the AGG returning -2.5%.

Our featured Model Portfolios all outperformed the AGG, with most being up for the month, and the Baseline outperforming the AGG ETF by 3.25%! The YTD outperformance over AGG is between +3.3% and +6.8%, with very low trailing Betas and Correlations reflecting the Activeness of our Model Portfolios.

The long-term Alpha is significant. This 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 these biases and flaws 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 performance has been tracked since 2017, with the Risk Targeting algorithms 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, since the SEC has shown no interest in fixing the Fixed Income Market Structure.

Annualized Alpha – 2016 to present versus:

	BM1: AGG	BM2: GOVT	BM3: MBB
Baseline: (ModelPort20)	**+3.5%**	**+4.0%**	**+4.0%**
Aggressive: (ModelPort55)	**+4.7%**	**+5.4%**	**+5.4%**
CoreAGG: (ModelPort91)	**+2.2%**	**+2.7%**	**+2.8%**
Diversified (ModelPort1)	**+3.7%**	**+4.2%**	**+4.2%**
Large-Diversified (ModelPort3)	**+2.9%**	**+3.3%**	**+3.3%**

Liquidity Analysis – Bloomberg's LQA

The monthly track record of our Model Portfolios is computed using Bloomberg's Total Return calculators, which assume execution at the closing price of each month.

Even though we are investing in exchange traded ETFs, real world execution is likely to differ from investor to investor, due to different sizes of orders, different brokers, different execution algos and order types used, and different trading venues where the orders are placed, which will likely realize some slippage from the Total Returns we are computing.

We are concerned about slippage costs, as we would like our model subscribers to realize the returns they are expecting. To assess this slippage risk, we have had discussions with ETF market makers, and also analyze TCA.

Smaller ETFs with lower AUM, or that invest in smaller or inherently less liquid sectors, are more likely to have wider bid-offer spreads, as they trade less often than larger benchmark ETFs. ETFs that use derivatives are also less liquid. Conversely, larger ETFs, and those that invest in more liquid underlying sectors have lower bid-offer spreads, and higher LQA scores.

In general, even in smaller ETFs in less liquid sectors, orders close in size to a Creation Unit of an ETF will have the lower bid-offer spreads than small orders, as such orders would not require a market maker to inventory excess shares or to short shares to the buyer, with the attendant financing costs and market risks.

Bloomberg has used quantitative tools to compute liquidity scores for ETFs and to estimate Bid-Offer spreads. Since our systematic portfolios of ETFs have numerous holdings, we computed the weighted portfolio statistics. This table shows the weighted Bloomberg LQA rank, the estimate of Bid-Offer spread, and the weighted average AUM of the funds in each model portfolio.

ARAM Model	BB-LQA Score	BB-LQA Bid-Offer Spread (est)	WAvg AUM ($MM)
MP20	76	$ 0.27	$ 175
MP55	77	$ 0.23	$ 162
MP91	89	$ 0.07	$ 201
MP1	86	$ 0.13	$ 455
MP3	93	$ 0.04	$ 3,123
AGG	100	$ 0.01	$ 105BB

It would be impossible to adjust the historical total returns described in our Fact Sheets for slippage, as execution quality would vary between users, and historical LQA statistics do not exist in any case. **To allow investors to make informed decisions about the current portfolios in our models, on each of our Fact Sheets we have shown the current model portfolio weighted Bloomberg LQA bid-offer spread estimate.**

This link describes the Bloomberg LQA tools:

https://www.bloomberg.com/company/press/bloomberg-wins-market-liquidity-risk-product-of-the-year-award-for-the-fifth-consecutive-time

To recap: we target the risk of the AGG, 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?'.

The model returns shown are all out of sample, after systematic rebalancing creates the following period's portfolio. Monthly total returns for funds used by our models and systems use Bloomberg's calculators to combine price changes and income returns. These are compounded to compute the Model Portfolio returns.

Please click on the linked Fact Sheets for more statistics. Please review our previous newsletters for details on the portfolio construction and rebalancing.

We currently custody at Charles Schwab and Interactive Brokers for our systematic strategies.

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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