ALPHA CENTAURI
Riskpremia – Made in Germany

Factors in the short – and for the long run

Surprizes are a major driver of capital markets and 2022 brought a lot of them for investors. Russia´s invasion in the Ukraine, double digit inflation rates, an abrupt end of QE and aggressive tightening by most of all central banks globally, comeback of positive yields in many bond markets and the return of positive equity/bond correlation to name few.

From a factor perspective, one of the surprizes of 2022 might have been, that the "Death of Value", which was often discussed during the underperformance of Value since 2018 will turn out as premature. Despite ongoing weakness in Europe, "purified" US Value Long/Short delivered double-digit performance during 2022, perhaps the first sign of a possible comeback. As a second, the large differences between European and US factor performance as well as large differences between Long/Short- and Long Only excess return performance might be surprising for many investors as well. In many cases, even the sign showed a different direction.

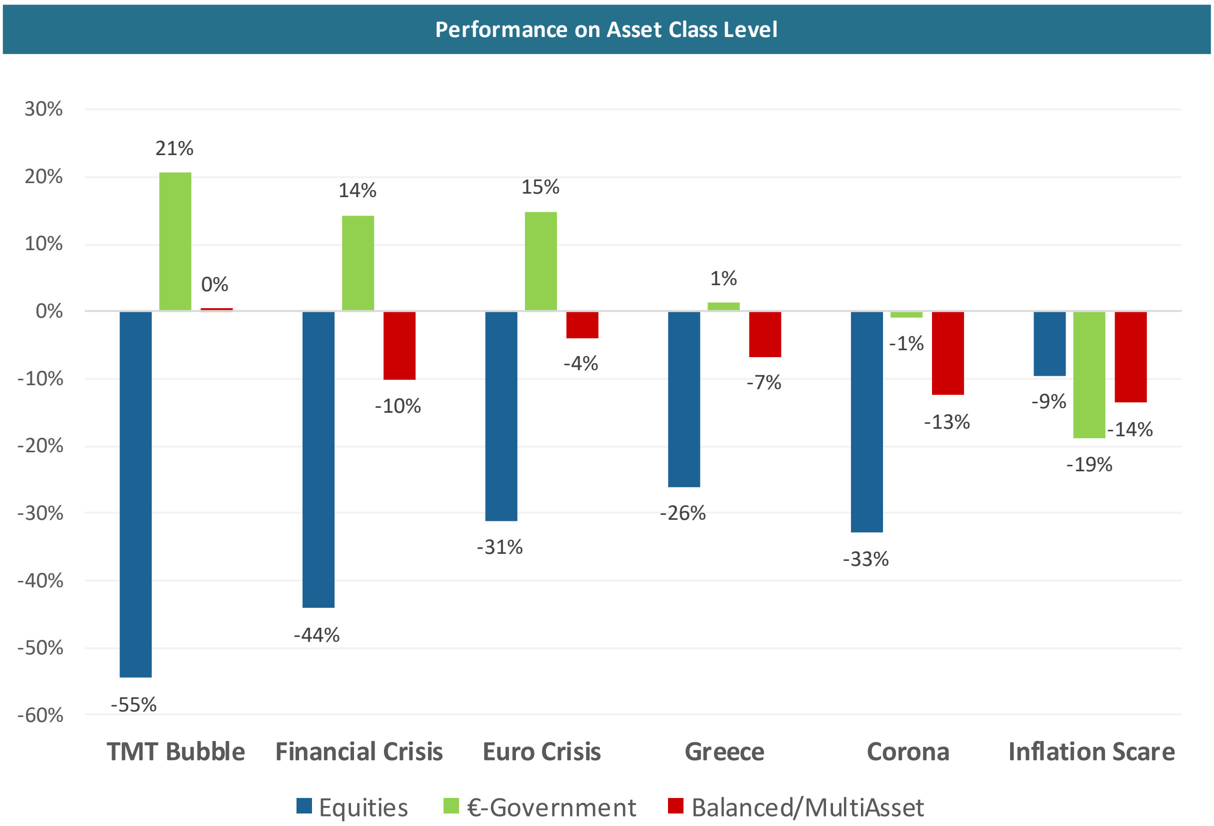
Factor-Performance 2022

LongShort		Long Only Active		Difference
Europe Low Risk	21,75%	Europe Low Risk	3,36%	18,38%
Europe Quality	8,71%	Europe Quality	-0,47%	9,18%
Europe Value	-12,94%	Europe Value	-10,28%	-2,66%
Europe Momentum	-7,18%	Europe Momentum	-2,03%	-5,15%
Europe Size	-16,25%	Europe Size	-3,10%	-13,15%
Europe Carry	0,05%	Europe Carry	-3,13%	3,18%
Europe Low Carbon	5,39%	Europe Low Carbon	0,97%	4,41%
Europe Multi	6,06%	Europe Multi	-0,81%	6,86%
USA Low Risk	-1,10%	USA Low Risk	6,03%	-7,13%
USA Quality	-0,52%	USA Quality	0,52%	-1,04%
USA Value	15,72%	USA Value	1,36%	14,36%
USA Momentum	-5,94%	USA Momentum	-0,73%	-5,21%
USA Size	-4,66%	USA Size	1,28%	-5,94%
USA Carry	-11,63%	USA Carry	1,51%	-13,15%
USA Low Carbon	-3,50%	USA Low Carbon	1,84%	-5,34%
USA Multi	5,22%	USA Multi	3,50%	1,72%

Excess Returns vs. Money Market (L/S) / Benchmark (LO act.) Source: Alpha Centauri

High and even double digit differences are even more astonishing when taking tracking errors and volatilities into account. Long/Short factors are constructed targeting an ex-ante volatility (or tracking error of short to long) of 5% while Long Only factors are constructed with a tracking error of 3% to benchmark.

The underperformance of Value for many years and the fact that bond investors in many markets lost all the returns accumulated over last 8 years in a couple of months are a reminder, that risk premia in traditional (i.e. rates, credit, equity etc.) as well as in alternative risk factors are paid for bearing tail risk and long phases of drawdowns - and not for simple volatility. We´ve extensively written about that over the last several years. A comprehensive list of publications can be found here.
As the correlation between equities and bonds turned positive again after more than 25 years since the triple Asia-/Russia-/LTCM crisis', investors lost more money in 2022 than during the financial crisis in Balanced and Multi Asset portfolios.



Source; Bloomberg, Alpha Centauri calculations

As the long run is an endless chain of "one-year short runs" for most - especially regulated institutional investors - it seems quite natural, that investors are looking for additional sources of diversification and market independent returns. In "Financial Anomalies in Asset Allocation: Risk Mitigation with Cross-Sectional Equity Strategies" (November 2022), the authors found, that factors can provide diversification opportunities in the short run during times of stress in traditional markets – but the results can vary dramatically over different time frames.
When the discussion about the diversification properties heated up during the Covid Crash in 2020, we provided a simple "do it yourself" – overlay solution for Europe in our publication entitled *"Risk Mitigation using EUREX Factor Futures"*. The Long/Short futures position worked well again in 2022 with a gain of ~5%.
Alternative risk premia and equity factors can provide opportunities in the long run, but "diversification" doesn´t always equal "negative beta" to equities and bonds in the short run. The properties of many risk premia and equity factors can change according to the economic and

market environment. Carry premia in bond markets delivered a proof of that over the last 8 years as the correlation to bond markets increased to nearly "one" due to the fact, that short term bond yields have been kept under control of central banks during the time of negative short-term rates.

Nevertheless, in "A century of Asset Allocation Crash Risk" (SSRN for latest version) , the authors tested a couple of asset allocation setups (Endowment, 60/40, Risk Parity, Diversified, Factor-based) on their risk/return characteristics and came out with an interesting result: *"While endowment strategy is a front runner in cumulative returns and surpasses both classic strategies, such as U.S. 60/40, Global 60/40, Diversified, and more sophisticated and innovative Risk Parity, Factor-Based, and Dynamic allocation, it only comes out third on the risk-adjusted basis, losing to Factor-Based and Dynamic strategies."*

The factor part of the test has been a portfolio of 15 risk premia across various liquid asset classes which was added by 30% to a basic 60/40 portfolio.

Moreover, AQR researchers recently published a well written paper entitled "Fact, Fiction and Factor Investing" confirming our views in writing: "*… and we show that each factor can suffer at times from prolonged drawdowns and infrequent, but extreme, underperformance…."* and *"…while even normally distributed returns can yield significant drawdowns, factor returns are less well behaved than a normal distribution. This is especially true over shorter intervals."*

Conclusion:
Short term outcomes in alternative risk premia – and equity factor investing can be quite volatile and exhibit even a different sign across various implementation methods (Long/Short vs. Smart Beta/ Long Only Excess Returns) in equities. Nevertheless, the opportunities for prudent and patient investors will play out in the long run as with traditional risk factors in rates, credit, and equities. In this sense, Robeco´s David Blitz might be right with the title of a recently published Journal of Portfolio management article: **"Factor Investing: The best is yet to Come."**

Factor performance:
Within Europe, Carry, Value and Size underperformed the most in an overall weak factor environment. Only Momentum was able to deliver a small positive excess return. In the US, the picture was completely different as all single factors outperformed the overall market. Momentum delivered the strongest excess returns and Quality the smallest.

Alpha Centauri Indexing - Data as of 30.12.2022

Description:

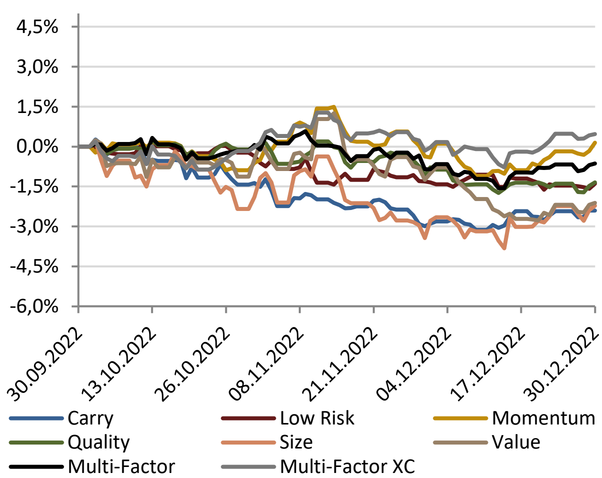
The iSTOXX Europe Single Factor index family developed by STOXX in collaboration with Alpha Centauri offers investors a unique and very innovative way to target and capture premia.
It consists of six single factors that aim to capture well-known risk premia and one multi-factor that aims at simultaneously capturing premia from the aggregate of all single factors rather than from just one source of risk alone.
All indices are constructed to maximize the exposure to their particular factor and minimize unwanted risks. While constructing the final indices the FIS APT risk model is used to measure and restrict risk.

For more information go to **www.alpha-centauri.com** or **www.stoxx.com**

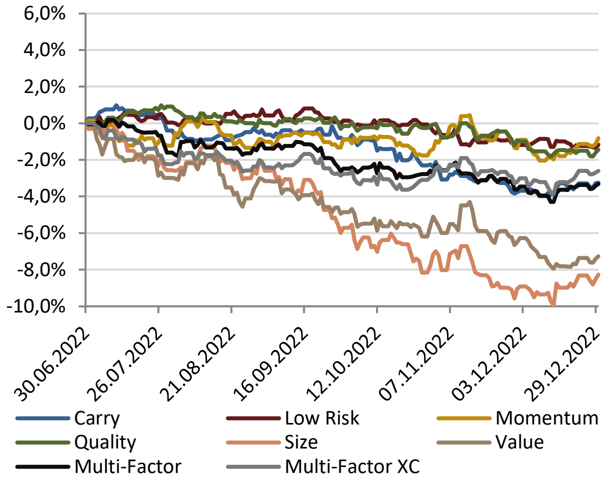
Performance and Volatility Breakdown

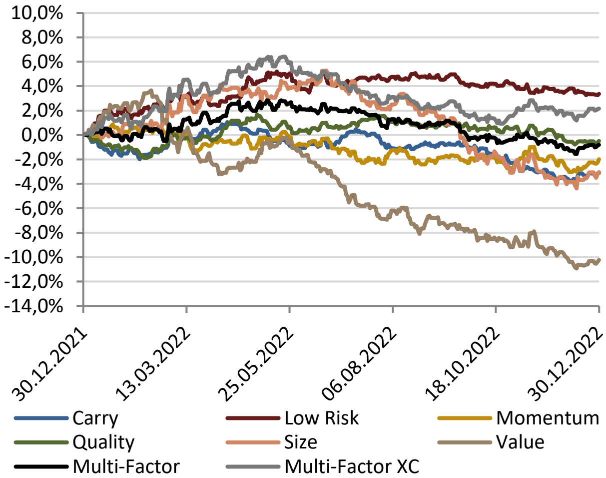
Name	Ticker	Return 3 Months	Return 6 Months	Return 12 Months	Return Live (1.4.)	Vola pa	Vola pa Live (1.4.)
Carry	ISECFER Index	7,4%	1,8%	-13,9%	58,5%	14,3%	14,0%
Low Risk	ISERRER Index	8,4%	3,9%	-7,4%	60,5%	13,3%	13,1%
Momentum	ISEMFER Index	10,0%	4,3%	-12,8%	44,9%	14,1%	13,8%
Quality	ISEQFER Index	8,5%	3,6%	-11,3%	49,4%	14,1%	13,8%
Size	ISEZFER Index	7,6%	-3,2%	-13,9%	41,0%	13,9%	13,6%
Value	ISEVFER Index	7,7%	-2,2%	-21,0%	0,5%	15,3%	14,9%
Multi-Factor	ISEXFER Index	9,2%	1,8%	-11,6%	38,0%	13,5%	13,2%
Multi-Factor XC	ISEXFCR Index	10,3%	2,5%	-8,7%	41,7%	13,6%	13,2%
Benchmark	SXXR Index	9,8%	5,1%	-10,8%	51,9%	14,4%	14,1%

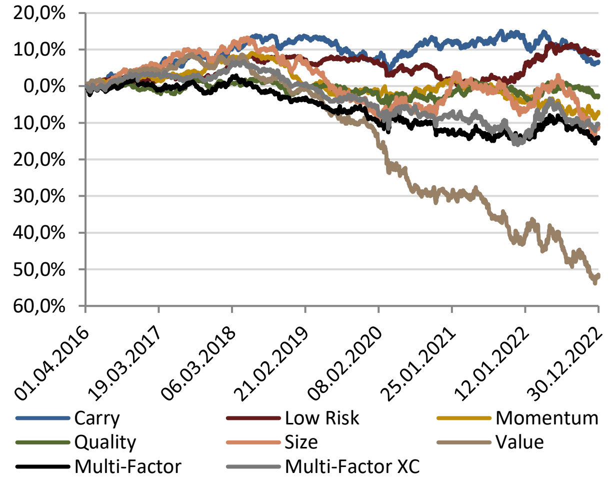
Excess Return 3 Months



Excess Return 6 Months







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