INVESTMENT INTELLIGENCE FOR THE FUND PROFESSIONAL
INVESTMENT EUROPE

- Caroline Allen
- 18 Apr 2013

TOBAM's Choueifaty reworks the sustainability theme

TOBAM Asset Management is taking the idea of sustainable investment back to its roots in response, it says, to the way the the concept is being increasingly stretched.

Almost as soon as the firm was launched, Paris-based TOBAM Asset Management signed up for the United National Principles for Responsible Investment (UNPRI), a code of conduct that obliges signatories to publish a report each year detailing their social investment activities.

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The manager counts CalPERS, the California Public Employees' Retirement System, as a significant shareholder (12.5%). It manages funds for the NOK4trn (€540bn) Norwegian Government Pension Fund Global, one of the world's most influential institutional investors, with a very public and ground-breaking commitment to responsible investment.

In addition, a 'significant' slice of TOBAM's revenue is donated each year to Amnesty International in France, and in 2010-2011, the firm compensated 125% of its annual carbon footprint. All employees are shareholders and TOBAM's compensation structures are highly transparent.

The meaning of sustainability

These and other measures demonstrate a strong and active support of the feel-good principles of sustainable investing. However, TOBAM Founder Yves Choueifaty (*pictured*) has redefined the term with a sharper edge, and a more accurate way.

Sustainability, he explains, means embedding responsible real returns (growth) achieved by innovative investing over the long term. 'Responsible' means respecting the whole investment process, starting with the clients, your own work, the resources used and the wider environment.

In fact, Choueifaty sees no point in doing anything else. "There is no sense in anything other than sustainable investing. Why would you even start something that is not sustainable? We don't talk of the short term because it is simply not sustainable, so it is a waste of time."

The rapid growth of assets under management at TOBAM indicates that Choueifaty's view is winning converts. He is a frequent public speaker and contributes white papers to academic journals. Think-tanks explain his Diversification Ratio, which diversifies the portfolio around sources of risk, rather than market capitalisation.

His logic is simple and relentless. He relates how he asks audiences: Can you tell the future? If you can, there is an implicit response: there is no need at all to diversify. You should put everything you have into that one absolute certainty. But if you can't tell the future, logically you have to diversify.

Taking that as a basis for everything he does, Choueifaty has evolved TOBAM's patented Anti-Benchmark strategies based on maximum diversification for long term returns.

The firm, with some €3.4bn in assets under management (a rise of 54% in 2012 alone) now runs 13 such strategies, the latest focused on Canada, after funds targeting Pacific ex-Japan (now at $50m) and Emerging Market Equities ($500m) were brought to the market in 2012 and 2011.

The anti-benchmark solution is based on the conviction that market capitalisation weighted indices are dangerous for investors, or "not sustainable". As demonstrated in the financial sector in 2007, tech/IT stocks in 2000 and oil in the 1980s, market-cap investing concentrates risk over time and leads to biases in precisely the sectors and stocks that should be avoided.

The strategies are implemented through a series of steps. First, quantitative research is carried out applying the anti-benchmark theory. Second, a liquidity filter and an optional socially responsible investment (SRI) filter are applied. Third, the portfolio is optimised using the algorithm that generates optimal stock weightings. Finally, internal limits and Ucits limits are applied alongside client guidelines.

"Diversification returns come from the corporate, not the manager," he explains.

"We try not to pollute the risk premium which the equity is delivering." The portfolio model is neutral and returns come from the holdings. "And by the way," he adds, "there is this pervasive confusion between being passive and being neutral. But if you are passive, you are certainly not neutral."

Benchmark investing

Investors still cling to benchmark investing for two reasons, he suggests. First, benchmarks are a widely used way of measuring performance and risk. Second, investors believe benchmark indices are efficient, even though the academic work they were originally based on included some unrealistic assumptions.

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"Unfortunately, everybody has forgotten about the assumptions and (still) take for granted the fact that benchmarks are efficient," he says.

He was attracted to the UN Principles for Responsible Investing because they do not try to describe what is good and what is bad. "It doesn't take a moral stand. It says that "sustainable" is good and "not sustainable" is destructive. So, yes, it may ask: is it sustainable to pollute and exploit and let the next generation handle that?"

In addition, it doesn't confuse 'unsustainability' and capitalism. "Capitalism is a sustainable system. In fact, it is the only one that is." He argues that the financial crisis had its roots in sub-prime lending – that is, lending to those who were unlikely to be able to reimburse the loans. "That is clearly not sustainable. If there was a good intention, it was an artificial and wrong way to implement it."

Another 'unsustainable' course, he notes, is the present lax monetary policy being followed by many central banks. "Printing money is simply not a remedy. Debtors and creditors need to take responsibility, and it is pointless to try to play the rich off against the poor. The solution needs to join both together."

Sustainable investment means ensuring there is a solid foundation for continuing asset growth and returns. Following the UNPRI meant that TOBAM was not trying to reinvent concepts which were already increasingly adopted by investors.

Instead, the TOBAM portfolios can filter out stocks that are not compliant, and follow the "extremely transparent" process of institutions like Norges Bank, which engages the management of a firm it is considering dropping from its lists.

A sustainable investment structure for most institutional investors is a core-satellite model, where the core component is managed conservatively or cautiously while the "speculative" satellite element is the opportunity to implement views. Choueifaty considers the model will become more widely adopted, combining the long-term core sustainable strategy with an innovative element.

Speculation, he adds, originally meant "to be able to see". "It has a role, and you can see various strategies come in and out of fashion. At the moment it is minimum variance or arbitrage opportunities, which are the opposite of diversification."

After initially focusing on leading institutional clients, TOBAM's clientele is expanding to include more intermediary/distribution channels. Will the firm have to diversify its own strategies if they become popular enough? Choueifaty says the firm's distribution is as sustainable as its investment models.

"We have no capacity issues because everything we do is driven by client demand."

TOBAM FACTS

- Distribution: via French asset manager Amundi, which bought a 17.5% stake in TOBAM.

- Asset gathering: by attracting key investors in each market, who draw in further interest.

- Returns: Systematic Quant-driven model aims to deliver the full risk premium across market cycles for any asset class.

- Patented mathematical measure: the Diversification Ratio, which measures the diversification of a portfolio or index across sources of risk.

• Client base is focused around large institutional clients worldwide.

Yves Choueifaty fact file:

• Having been chief executive of Credit Lyonnais Asset Management, he became chief investment officer of Calyon when his company merged with Crédit Agricole in 2004.

• He created TOBAM in June 2005 with seed funding from JP Morgan and Lehman Brothers executives. A year later, he brought TOBAM to Lehman as managing director of its quantitative asset management Europe team.

• When Lehman collapsed on 15 September 2008, Choueifaty had to replan and get new clearances from a variety of regulatory authorities. Since then, the company has stabilised and grown. The firm, with some €3.4bn in assets under management.