Institutional Investor

Don’t Call This French Fund Manager a Dinosaur

19 JUN 2013 - TOM BUERKLE

Yves Choueifaty would have you believe he is a man without a strategy. Nothing could be further from the truth.

Choueifaty is founder and head of Tobam, a Paris-based quantitative asset manager that offers one of the more distinctive approaches in the increasingly popular "smart beta" investment space. He launched the firm in 2005 to provide a solution to the basic dilemma of indexing strategies: They track market cap weightings. An equity index product maximizes its allocation to particular stocks when they hit their peak; think General Motors Corp. in 1972 or tech stocks in 2000. “You are buying unwanted bias,” says Choueifaty.

To get around that problem, many asset managers have come up with variations on standard indexing in recent years. These smart beta strategies range from funds that tilt toward low-volatility stocks to funds that selectively screen out certain high-risk securities, such as bonds from euro area periphery countries, to those that focus on high-dividend stocks. Many exchange-traded funds use smart beta strategies.

Almost all such strategies involve some kind of active, or implicit, choice by the manager. Stephen Miles, a consultant at Towers Watson in London, noted in a recent research note many low-volatility strategies were heavily weighted to financial stocks before the financial crisis, providing investors with a false sense of security.

By contrast, Tobam’s core logic is to follow the first rule of Harry Markowitz, the legendary founder of modern portfolio theory: diversification. The firm aims to give investors exposure to the equity market with maximum diversification.

Tobam employs an algorithm that selects stocks according to two criteria: volatility and correlation. In effect, it chooses a basket of stocks that have the least correlation with each other. It rebalances its holdings every month in developed markets and every quarter in emerging markets. Those criteria allow Tobam to capture market returns without any hidden bias, and do so with less volatility than the underlying market, Choueifaty claims. He calls Tobam "the anti-benchmark."

"I am trying to build the unbiased portfolio, the most diversified portfolio," he says. "I am the only portfolio manager in the world that doesn't have an alpha. The anti-benchmark doesn't have a strategy. I am the absence of strategy."

Choueifaty's idea has taken some time to gain traction. He launched Tobam in 2005, sold it to Lehman Brothers Holdings the following year, and then bought the firm back with his employees after Lehman failed. The firm was managing $600 million at the time.

He scored a breakthrough in 2011 when the California Public Employees' Retirement System (CalPERS) took a 17.5 percent stake in Tobam and gave the firm a $150 million mandate. Amundi, the big French asset manager, bought a 17.5 percent stake in May 2012 from Tobam employees and CalPERS; the California pension retains a 12.5 percent stake. Amundi, which manages nearly €750 billion ($1 trillion) in assets, has put Tobam on its Next Generation equity platform. Since that deal, Tobam's assets under management have virtually doubled, to $4.4 billion.

Tobam's World Equity strategy has produced gross returns of 16.45 percent year-to-date as of June 14, compared with 10.65 percent for the MISCI Daily TR Net World index. Its Emerging Markets Equity strategy had a gross return of -3.28 percent, compared with -8.47 percent for the MSCI Daily TR Net Emerging Markets index. Its U.S. Equity strategy returned 20.94 percent, compared with 14.7 percent for the MSCI Daily TR Net USA index.

Tobam may be getting bigger, but Choueifaty seems at home in the role of the small underdog. He illustrates his approach with a PowerPoint slide showing a picture of a Tyrannosaurus Rex alongside a Crusafontia, a small mammal of the Mesozoic era that was the forerunner of today's rat. If any human had been around 100 million years ago, he or she would surely have bet on T. Rex surviving to the modern era. Nature, of course, took a different path.

“Life does not try to forecast. Life spreads the bets,” says Choueifaty. “The only source of risk premium is diversification. I am the only portfolio manager with a track record of three billion years.”