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France's Tobam contests benchmarks via diversification

By John Sedgwick March 18, 2015

Paris-based Tobam aims to do exactly what it says on the tin, "think outside the box". The company's "anti-benchmark" diversification investment strategies offer a solution to the assertion that market-cap weighted benchmarks carry inherent non-neutral concentration risk.

Yves Choueifaty, Tobam

"There is a huge confusion in the industry between passive and neutral investments," says Yves Choueifaty, the company's Paris-based president and founder. "Most people believe that, to be neutral, they should buy the benchmark. But when they buy the benchmark they are buying a hugely biased portfolio."

Tobam has patented its investment strategy in the U.S., Australia and Japan, with Canada to follow, and plans to do the same in other countries.

"You can patent any manufacturing process, and we are in the process of manufacturing a portfolio," Choueifaty says.

Choueifaty founded Tobam in 2005, launching the company's anti-benchmark strategies based on the investment philosophy that, if it is difficult to forecast the market, the first step should then be to ensure maximum diversification.

Tobam's quantitative investment model employs measurements of volatility and correlation to determine allocation and create a diversified portfolio.

"We try to build the most diversified portfolio you can build across any given universe of investments," he says. "And I have never met with a client that has ever told me that diversification doesn't make sense."

Choueifaty says this creates a portfolio with less risk than one with a market-cap weighted benchmark and also leads to outperformance.

In 2012, the MSCI U.S. Index gained 32%, while Tobam's anti-benchmark U.S. strategy returned 40%, and in 2013 the fund outperformed the same benchmark by 4%, he says.

He points out traditional market-cap weighted benchmarks are not a neutral risk allocator; they overweight sectors where concentration risk to a certain industry is already high.

At the time of the 1979 oil shock crisis, energy stocks' weighting on the S&P 500 index was at their highest; at the point the dot-com bubble burst in 2000, allocation to information technology companies was highest; and at the point of the global financial crisis in 2008, the weighting of the financial sector was the highest, he explains.

The better those sectors perform, the more the benchmarks increase their risk allocations to them, he adds.

Asia growth targets

Tobam is 80% employee-owned, with Amundi Asset Management owning 12% of the company and California Public Employees' Retirement System (Calpers) owning 8%.

Amundi represents the company's strategies to potential investors in Asia and the Middle East and has been doing so since mid-2013.

Tobam currently has fewer than 10 clients in Asia at the moment, which include a "very large sovereign wealth fund" and other corporate pensions, according to Choueifaty. Initial success came from the Japanese market, but the company has since secured business from Taiwan, South Korea, Hong Kong and South Asia.

Smart beta strategies are gaining momentum among larger institutional investors in Asia.

Mariko Yanada, Tokyo-based managing director at Nomura Asset Management (Nomura AM), told *Ignites Asia* in November last year that about 20% of Japan's several hundred corporate pensions have embraced smart beta and about 50% have shown interest in the strategies.

Taiwan's Bureau of Labor Fund (BLF) issued a US$4.35 billion smart beta mandate for 18 external managers to invest in overseas credit and equities in January, as reported. Risk-factor investing and smart beta investments are also emerging trends among Singapore's institutional investors.

Tobam's global assets under management (AUM) grew 276% in two years to end-2014. Its AUM is at US$8.7 billion this month, and Choueifaty predicts that figure will approach US$15 billion by year-end, with a sizable amount coming from Asia.

Just 3% of the company's clients were from Asia and the Middle East in end-2014, but that has grown to 8% this month and Choueifaty aims to grow it to 15% by end-2015.

The company's four most popular strategies among Asian clients are the Anti-Benchmark US Equity, Anti-Benchmark All Countries World Equity, Anti-Benchmark Emerging Markets Equity, and Anti-Benchmark Global Equity, he says.

But it also has Asia-focused strategies: the Anti-Benchmark Pacific Ex-Japan Equity and the Anti-Benchmark Japan Equity. Tobam also launched its South Korea strategy in end-2014. It has returned 6.5% since inception, while the index was up 1.2% over the same period, Choueifaty says.

Passive management: "perfect oxymoron"

Choueifaty has a unique take on the rise of passive investment management strategies.

Over breakfast with a CEO of one of the largest asset managers in the U.S. earlier this year, he was asked what the future will hold in the battle between active and passive management.

"My answer was that in my mind passive management was one of the most bizarre expressions that I have ever heard," he says. "Passive management, if you think about it, is almost the perfect oxymoron. How can you be passive and manage, and how can you manage and be passive?"

The growth in passive investing is based on the misunderstanding that passive investing equates to neutral investment, Choueifaty says.

He adds that it belongs to the world of the custodian and that more and more sophisticated investors believe passive investing does not make sense in the medium term.

Exchange-traded funds (ETFs) may offer a "minute advantage" by facilitating intraday trading, but the cost of this advantage is enormous in terms of transparency, bid-ask spread and the use of very exotic derivatives, so there are hidden risks everywhere, he says.

A portfolio is unpredictable when it is taking bets on the market. "When your only goal is to avoid bets, your goal is in a way much easier," he says.