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TOBAM talks up 'anti-benchmark' strategy
By Derek Au

Big Asian institutional investors are increasingly making use of smart beta strategies to achieve better risk diversification, according to Think Out of the Box Asset Management (TOBAM).

Speaking to Asia Asset Management, Yves Choueifaty, the Paris-based company's founder, says that the firm's patented anti-benchmark strategy – which falls within the broad scope of what is defined as smart beta – is the only strategy his firm offers to clients. These include public entities such as sovereign wealth funds and pension funds. As of the middle of March, the firm's AUM had doubled to 8.2 billion euros (US$8.9 billion) year-on-year, which he claims demonstrates the growing appeal of the strategy.

"I think the story is quite compelling; it is based on common sense and the fact that if the markets are difficult to forecast, it is better for you to diversify. I think there are plenty of sophisticated investors in Asia who understand that," he explains.

In fact, Mr. Choueifaty says Asian institutions currently make up only a small part of TOBAM's business: only 8% of its collective AUM stems from this region and the Middle East, whereas Europe and North America account for 58% and 34%, respectively.

In his view, smart beta strategies are more efficient diversifiers compared to passive strategies based on traditional market-cap weighted benchmarks. The latter, he explains, are too unduly skewed toward companies with high valuations.

"There is only one common belief among all smart-beta strategies; namely that the market-cap weighted benchmark is dumb," Mr. Choueifaty contends. "It maximises your allocation in the worst moment."

Citing historical data, he reasons that market-cap weighted benchmarks have misled investors into taking overweight positions in overheated industries, such as the internet, oil and financial sectors, immediately prior to their collapse.

"Most sophisticated investors around the globe are convinced that market-cap weighted benchmarks are not efficient. The error would be to believe that this is the case because markets are not efficient. It is in fact the other way around; the reality is that while markets are quite efficient, they are difficult to forecast. The problem with benchmarks is actually that they are not diversified," he continues.

In theory, an efficient market means asset prices fully reflect the relevant information flow. If that were true, however, investors would be left with no chance to capitalise on market forecasts.

For that reason, Mr. Choueifaty believes diversification is the best strategy for investors that do not want to rely on market forecasts. He also believes that smart beta can help to construct highly-diversified portfolios without bias towards a company's market capitalisation, price volatility, level of dividends and earnings growth.

Some critics say that smart beta strategies put too much emphasis on standard deviation as a measurement of risk, because doing so tends to underestimate the risk involved. Mr. Choueifaty, however, believes this is not an issue, with most risk measurement approaches for smart beta leading to quite similar results when used in the portfolio construction process, especially in the case of equity portfolios.

"What is critical is not the risk measurement you take, but the purpose for which you use it. Our solution aims at building the most diversified portfolios, and we have shown that the nature of their performance is robustly based on the risk measurement used to construct them," he concludes.

Founded in 2005, TOBAM's shareholders include Amundi Asset Management and the California Public Employees' Retirement System (CalPERS), the largest pension fund in the US.

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