FINANCIAL POST

Diversification the key to Paris money manager's 'agnostic portfolio'

Barry Critchley | April 7, 2017 2:20 PM ET

Peter J. Thompson/National PostTowers in Toronto's financial district.

Over lunch, Christophe Roehri, deputy chief executive of TOBAM, a Paris-based money manager, presents a straightforward message: market cap indexes are not very efficient.

As a corollary, he argues investors can do better than the market, with a “maximum diversification strategy” which he says is the best way to produce excess returns. And that strategy, or at least the methodology behind the investment process, has resulted in the firm receiving patents in Australia, Japan and the U.S.

To illustrate his central point, Roehri displays a graph of the S&P 500 index showing which sectors have dominated (in terms of market weight) over the past 55 years. Technology is now the dominant sector; a decade earlier it was the financials; at the turn of the new millennium it was technology, media and telecom; 35 years back it was the energy producers; and 45 years ago it was autos.

“The benchmark indexes tend to be poorly diversified,” he said, noting when stocks become “expensive,” their weight in the index increases, meaning investors are required to buy more. (When stocks are cheap, the opposite situation prevails.) “If you buy the benchmark, you are betting on (continued) concentration.”

TOBAM, which is home to “lots of maths guys,” has developed its own measure of diversification, the diversification ratio, the measure for which it received patents.

In simple terms, diversification is achieved when the risk of the combination of the stocks in a portfolio is less than the combination of the risks of the stocks in the portfolio. (The idea is to add stocks to the portfolio provided that diversification is increased.) The diversification ratio results from dividing the combination of the risks by the risk of the combination.

The result of all the math is what Roehri calls is an “agnostic portfolio,” one, he said that’s free of bias and made without forecasts or bets. (The portfolio is re-balanced each quarter.)

But caps and minimum weights are placed on the number of stocks in the portfolio: for the U.S. product the maximum weight is 1.50 per cent; for the Canadian product the cap is three per cent.

On a back-tested basis, Roehri said TOBAM’s approach, across a number of markets, generates an excess return of one per cent — three percent — and a reduction in volatility of 15-20 per cent — relative to the benchmark. (A cynic would say that there’s never been a bad back-test.)

He adds maximum diversification differs from a so-called “smart beta” strategy and a low volatility strategy. “We are a little bit of everything,” adding TOBAM should be a “core portfolio” for investors.

Roehri is in Canada as part of a marketing effort to attract retail investors. Last year TOBAM and Mackenzie Investment Partners signed a deal where a series of ETFs based on the former’s Maximum Diversification Index Series would be launched. Those efforts have resulted in about $150 million of assets.

That partnership was established after TOBAM secured mandates (totaling US$1.5 billion) from a number of Canadian institutions.

“We created a company in 2005 around a concept. Institutional investors are the best investors to buy a concept. And there are a lot of large sophisticated institutional investors in Canada,” he said.

Financial Post
bcritchley@postmedia.com