



ossiam

INVESTIRE NELLE BLUE CHIP CON INDICI ALTERNATIVI AI MARKET CAP

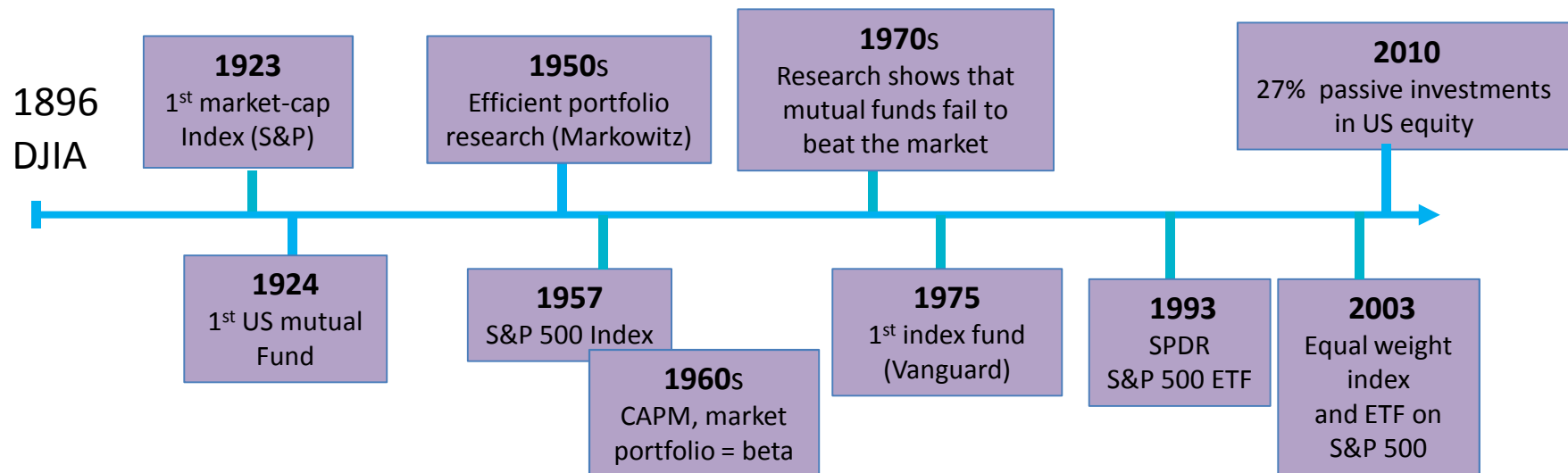
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This material is provided for information only to Professional or Qualified Investors

- ④ Equity market indices – dominance of market capitalization
 - ▼ Historical degeneration : from market indices to indexing and ETFs
 - ▼ Market indices as investments: properties and efficiency debates

- ④ Alternative weighting schemes : towards efficient betas
 - ▼ Classification of weighting methodologies
 - ▼ Example of Minimum variance



- Ⓣ **Simplicity :**
 - ▼ Methodology is easy to explain and understand

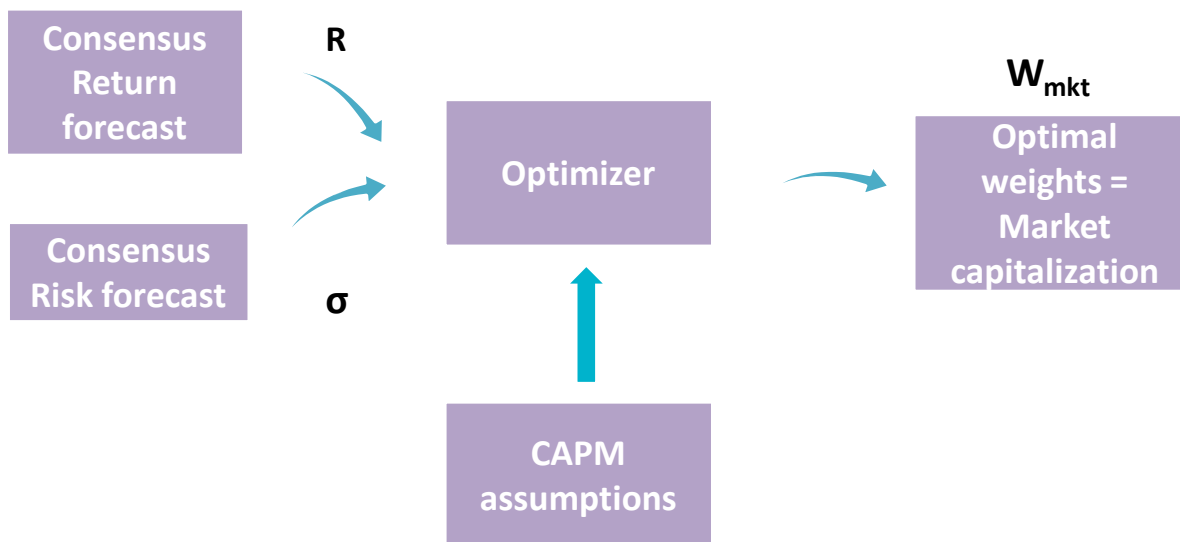
- Ⓣ **Passivity:**
 - ▼ Weights automatically adjust to the performance of index components
 - ▼ Market Cap Weighting is the only truly passive strategy (safe additions/deletions in the index)

- Ⓣ **Liquidity:**
 - ▼ Large stocks generally exhibit high liquidity, making indices easy to replicate

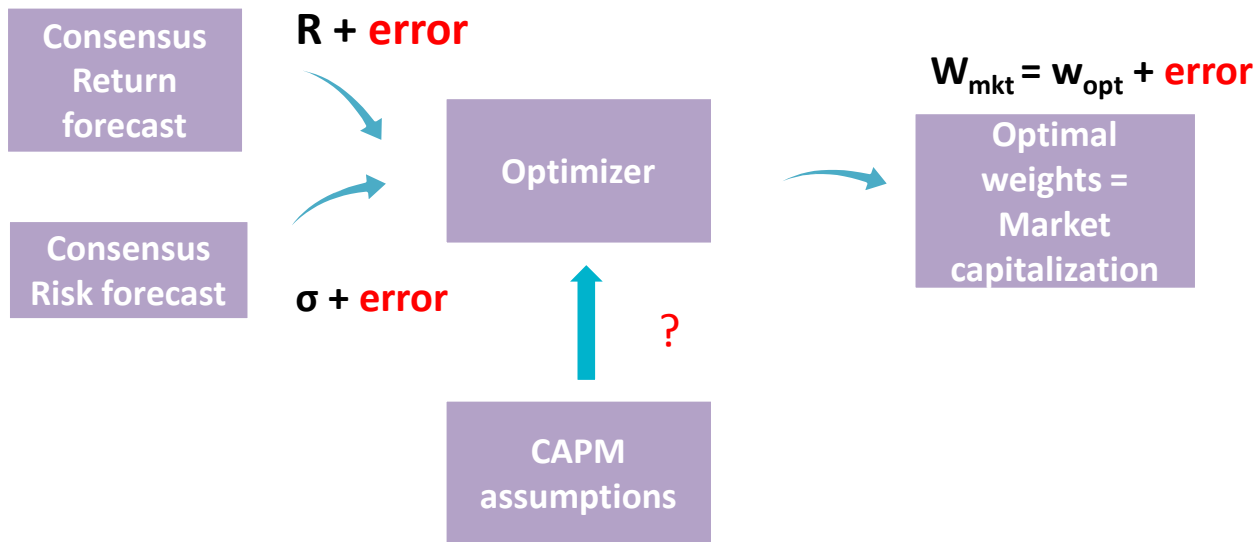
- Ⓣ **Optimal Portfolio under Efficient Market Hypothesis :**
 - ▼ Market Cap Weighting reflects rational expectations of all investors at any time

- Ⓣ **Investors are historically used to these benchmarks**

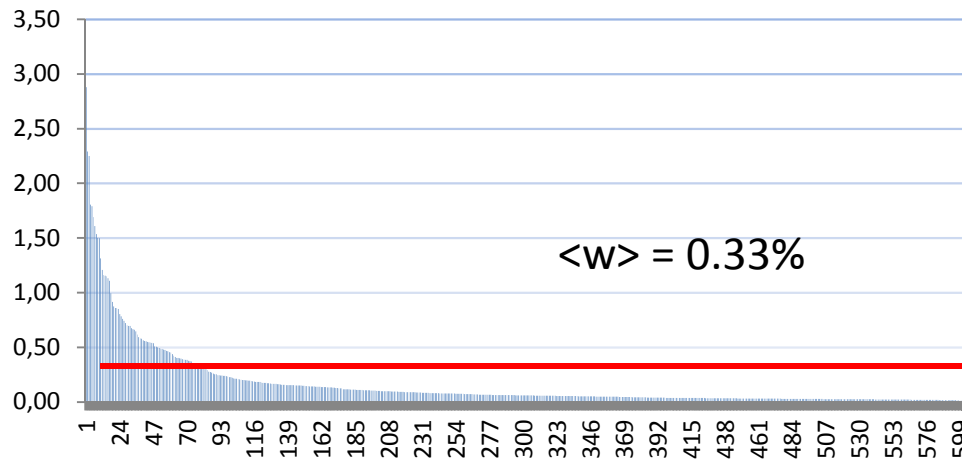
Implicit optimization behind the market-capitalization weighting



Theoretical foundations are questioned

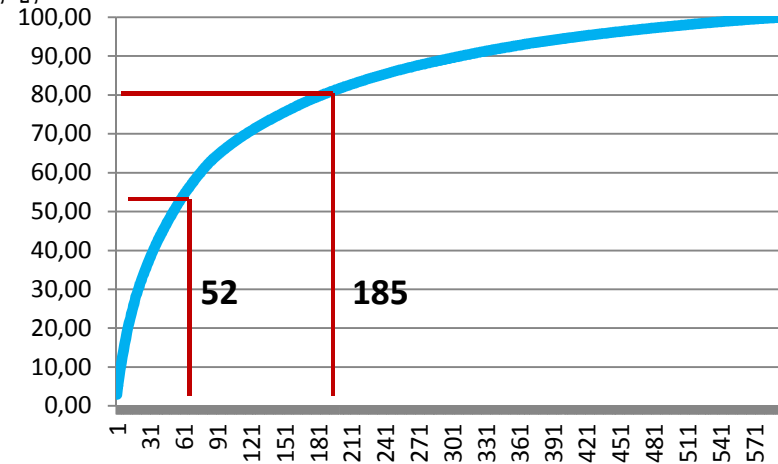


Mega-cap bias



STOXX Europe 600 Weight Distribution, as of July 2011

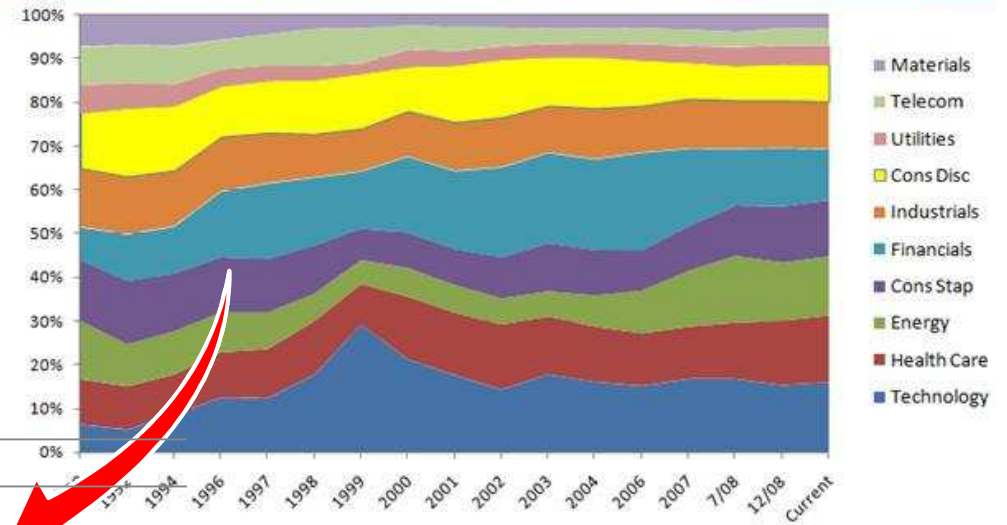
Cumulative weight



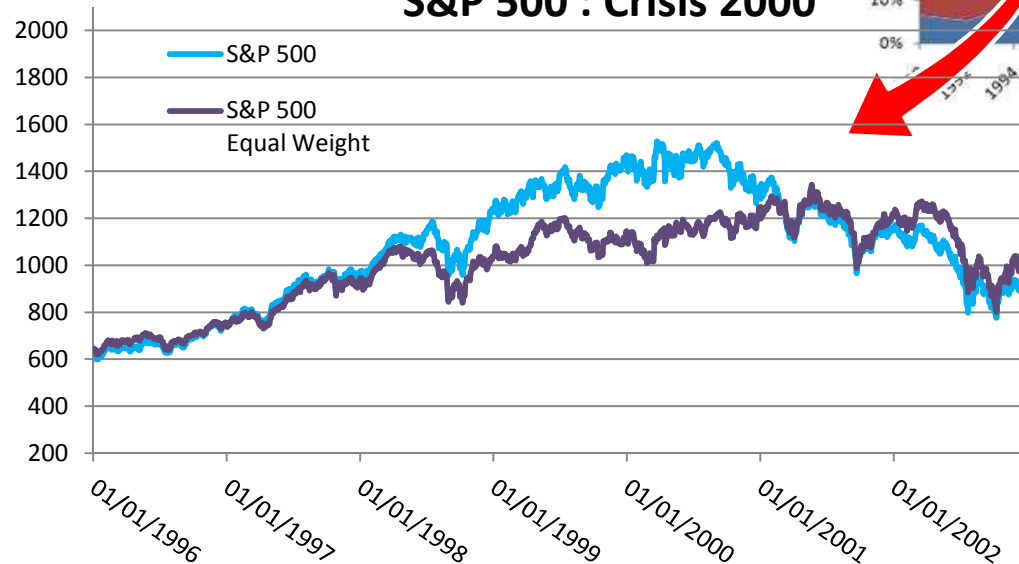
Source: *STOXX*
Calculated by Ossiam

PRACTICAL PROBLEM 2 : BUBBLE-FOLLOWING

Historical Sector Weightings of the S&P 500



S&P 500 : Crisis 2000



Source: S&P
Calculated by Ossiam

Source: Bloomberg

- Adjust inherent biases of market cap weighted indices
- Emphasis on risk control in the allocation process
- Convert asset manager's beliefs into systematic investment strategies

DIVERSIFICATION

-do not use explicit risk/return forecasts

- set up diversification objectives based on weight distribution

- Equal Weight
- Intech Diversity Index

RISK

- do not rely on return forecast/ build return forecast from the risk

- use estimated historical risk to build risk-efficient portfolio

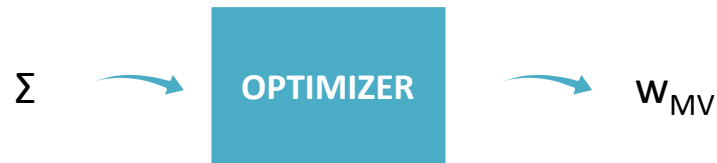
- Minimum Variance,
- Maximum Diversification,
- Risk-Weighting

FUNDAMENTALS

- use fundamentals to assess the "fair value"

-Set up diversification objectives build on fundamentals

- RAFI Fundamental Indexes
- Dividend / Earnings Weighting
- GDP Weighting



Seeks minimum possible risk without active views on expected returns

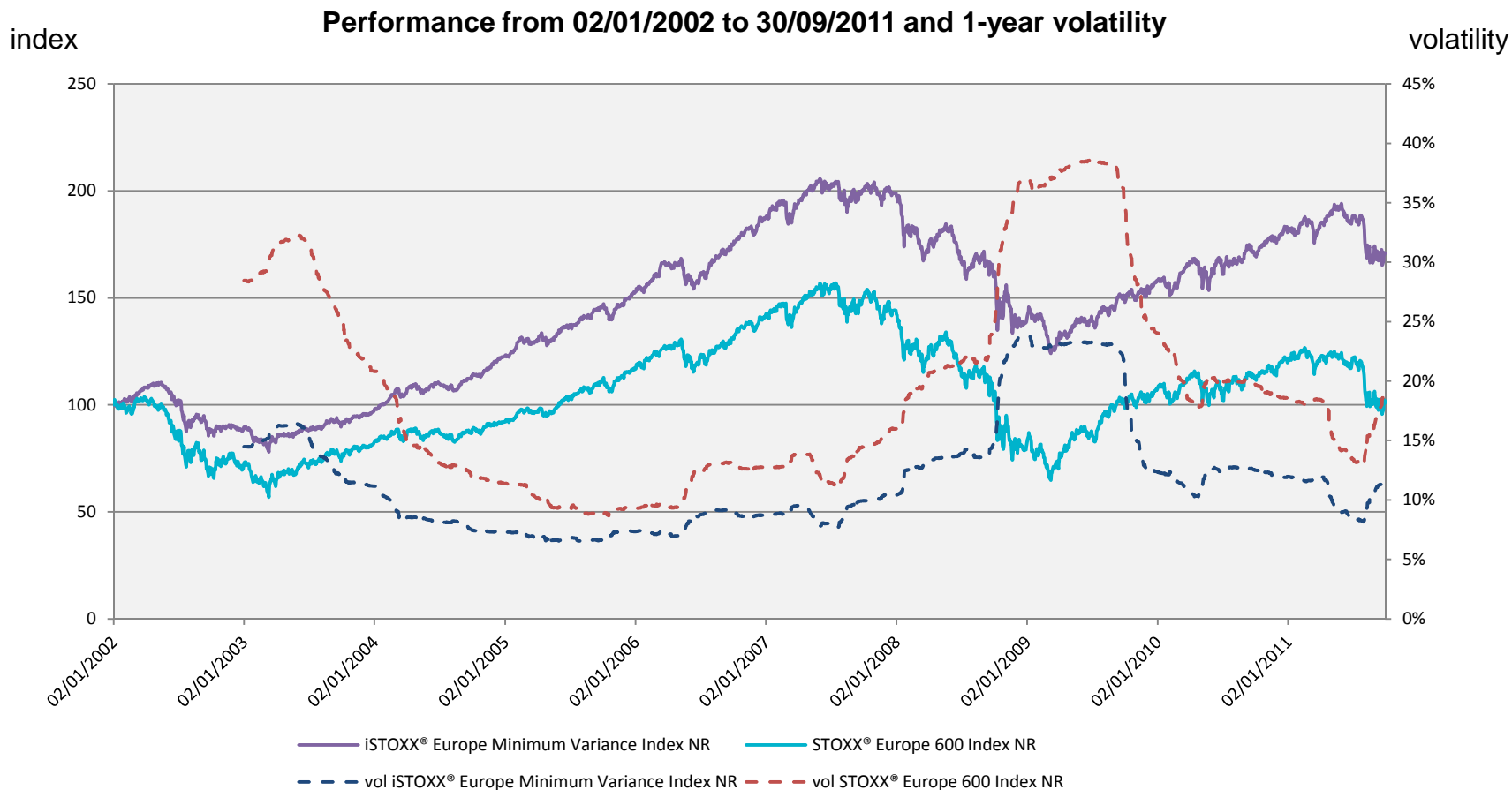
MOTIVATION

- risk persistence allows to extract value from historical risk estimation
- ignoring returns forecasts eliminates distortion because of forecasting errors
- low-volatility stocks historically had very attractive performance [Haugen et al, 2008]

STRATEGY FEATURES

- selective approach: many of stocks will be assigned zero weight
- sensitive to underestimation of risk: additional anti-concentration mechanisms are the must (maximum weight, robust estimation technique for covariance,..)
- benefits from a liquidity filter attached – allows to control liquidity of the allocation
- turnover is non-negligible, but no crucial impact of the rebalancing cost on the performance
- attention to additional constraints: different index providers might add substantial complexity to the minimum variance engine

iSTOXX® EUROPE MINIMUM VARIANCE INDEX NET RETURN VS STOXX® EUROPE 600 INDEX NR PERFORMANCE AND VOLATILITY



Source: Bloomberg – Calculation by Ossiam

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