A contrarian perspective: Q&A with Edouard Laurent-Bellue

By Hugh Leask

With long-term volatility likely to remain at elevated levels, the LFIS Vision UCITS – Perspective Fund is primed to capitalise on opportunities in rangy equity markets.

The fund – which is run by Edouard Laurent-Bellue, partner and head of fund solutions at the Paris-based quantitative investment manager – allocates to traditional credit and equity assets, while also taking a "fresh look" approach at the established model of multi-asset investing.

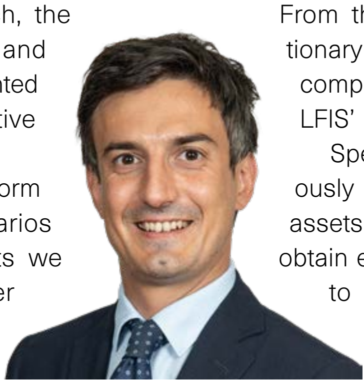
The Perspective strategy's carry and contrarian approach, built around strict allocation and risk management guidelines and limited idiosyncratic risk, has helped it not only weather 2020's turbulent environment but also demonstrate solid performance amid the challenges.

As markets rebounded sharply following the coronavirus-driven market sell-off, the Perspective strategy – which originally launched in 2013 in a dedicated fund format – had already remained structurally less exposed to equities into the month of March.

In a wide-ranging Q&A with Hedgeweek, Edouard Laurent-Bellue explains how the fund's investment model has helped it remained resilient during the recent historic market downturn, and discusses investment opportunities as uncertainty lies ahead.

Can you briefly describe the LFIS Vision UCITS – Perspective fund, and its investment strategy and process?

Perspective invests mainly in European equities and high-grade bonds but, in a departure from the traditional multi-asset approach, the strategy has an assumed carry and mean-reverting bias and is implemented using liquid, index-based derivative instruments.



This positions Perspective to perform in a wide range of market scenarios including the rangy equity markets we have experienced in Europe over the last ten years. The result is a daily liquidity fund with enhanced exposure to traditional asset classes, simple risk parameters and reduced idiosyncratic risk.

Perspective's portfolio is divided into two allocations. The main 'core' allocation aims to capture the insurance premium embedded in high quality credit risk and remote downside scenarios for equity markets. LFIS uses credit default swaps, futures and options to build a "risk on" portfolio with a carry and mean-reverting bias. The beta to equities over a cycle is expected to be around 40 per cent and the management team aims to add value by comparing the remuneration available for similar risks across different markets and instruments

A minority 'diversifying' allocation is made up of strategies with additional carry potential and low/negative correlation to the core allocation. This includes interest rate duration strategies, a traditional diversifier for multi-asset funds and other strategies as we believe it is key now, more than ever, to have access to other sources of potential uncorrelated performance.

What makes the LFIS Perspective fund unique from other strategies in this sector?

Perspective's contrarian approach is one differentiator, and this is designed to provide investors with a more stable overall return stream.

The fund also takes a quantitative rather than macro approach. In other words, Perspective does not rely on "market timing." LFIS has a different way of looking at the world. We use quantitative metrics and expertise to understand flow dynamics across markets and instruments.

From there, we make processed, discretionary portfolio management decisions by comparing assets and instruments using LFIS' proprietary C2R (carry-to-risk) metric.

Specifically, we rigorously and continuously screen the inherent carry of various assets, and instruments by which we can obtain exposure to these assets, compared to a full assessment of the associated risks, including extreme risk scenarios.

What is your target return?

The fund seeks to deliver 4 per cent per annum net, above cash over the medium-term (five years) with a higher Sharpe ratio and lower volatility versus European equities. LFIS has run the Perspective strategy since 2013, but the fund was only opened to external investors in 2019.

What is Perspective's year-to-date performance?

Perspective's performance year-to-date as of May 29th is -2.22 per cent, as compared to -17.7 per cent for the Euro Stoxx 50 Total Return Index (net dividends reinvested), the fund's main risk factor being European large cap equities.

Perspective has therefore shown strong resilience, suffering only one-eighth of the losses of equities. This should also be considered in light of Perspective's target beta of 40 per cent.

How have your target markets performed during the Covid-19 downturn?

Perspective's contrarian bias means that its equity beta will mechanically increase when markets fall, and vice versa. After the strong equity rally in 2019, Perspective therefore entered the Covid-19 crisis with low risk levels.

Perspective captured only approximately 23 per cent of the fall in equities in Q1 2020 relative to the Euro Stoxx 50. This is especially notable given the speed and magnitude of the Covid-19 market crash, as well as Perspective's underlying approach of betting against extreme market scenarios.

The fund's resilience in Q1 2020 was due to, one, its relatively defensive positioning heading into the Covid-19 crash, and, two, its active portfolio management during the crisis.

Can you talk about some of the positions and themes that have driven recent performance?

We can point to two main decisions that drove performance. One, our core allocation, whose theme focused around anticipating a volatility hike; and two, the diversifying allocation, which centred around identifying a weak asset in the crisis.

Firstly, given the novel, highly uncertain overall context, portfolio management anticipated that long term volatility, having actually fallen slightly in the initial market downturn in February, would increase if markets dropped again.

To protect the portfolio, Perspective switched its equity exposure from options to futures. In the context where long-term volatility was set to rise, the risk return profile of options positions had deteriorated significantly. These expectations were borne out by the increase in long-term volatility in the second, sharper phase of the market decline in March.

With regards to number two, the diversifying allocation, in early March, Perspective entered into a short position on Euro Stoxx December 21 dividends. Fund management was convinced that the Covid-19 crisis would significantly impact 2020 earnings and thereby 2021 dividends, something which was not yet reflected in implied levels.

In March, 2021 dividends lost more than 50 per cent of their value compared to a 16.2 per cent decline for the overall Euro Stoxx. Later in March, Perspective also took a short position on 2020 dividends in recognition of their level of political sensitivity in a context of state-sponsored aid, and their 'first-to-fall' status in the capital structure in times of stress.

Perspective exited these positions at the end of March with a performance gain of 3 per cent (gross) overall.

How has the Covid-19 downturn shaped your strategy?

In Q2, as visibility on the progression of the Covid-19 epidemic has improved to a certain extent, but with implied volatility levels remaining elevated, Perspective began progressively increasing switching back into options for its equity exposure, while keeping overall equity exposure levels stable.

For an idea of performance in an up-market, notwithstanding the fund's contrarian orientation, Perspective delivered strong absolute returns in 2019. The strategy generated returns of 11.3 per cent – versus 28.3 per cent for the Euro Stoxx 50 – with volatility of 3.8 per cent (versus 12.8% for the index) for a Sharpe ratio of 3.1.

Perspective provides a strong long-term return profile of consistent performance since launch in 2013. Perspective captured 40 per cent of the increase in the Euro Stoxx in 2019, suffered less than 30 per cent of the index's fall in 2018 and captured almost 80 per cent of the more moderate index increase in 2017.

How would you describe investor appetite for such strategies at the moment? What kind of questions are investors raising with you?

There will certainly continue to be demand for multi-asset solutions. We believe that, with interest rates where they are today, demand for differentiated multi-asset solutions with other sources of diversification beyond interest rate duration will likely grow.

Perspective's performance through the Covid-19 crisis should be reassuring for investors looking for a fund that targets upside capture but also offers a level of protection on the downside. The fund's contrarian approach is very much in tune with the current mood of the market with erratic performance expected for some time across traditional asset classes.

Investors are generally more familiar with traditional multi-asset approaches which combine a macro view with cash instruments. There is therefore some education to do around LFIS' approach. It is never easy to break new ground. ■