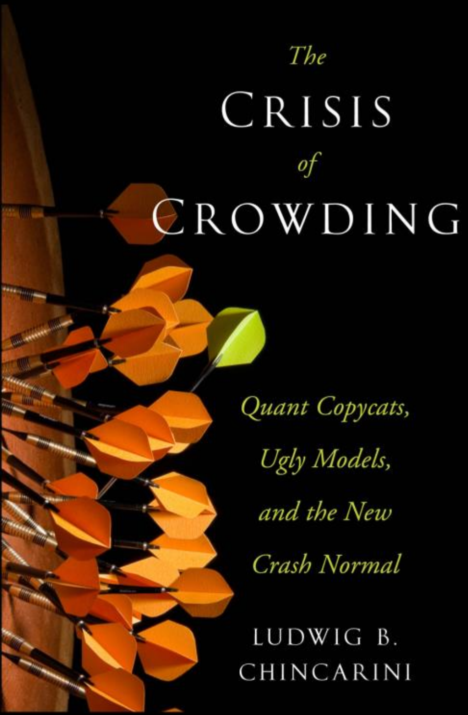
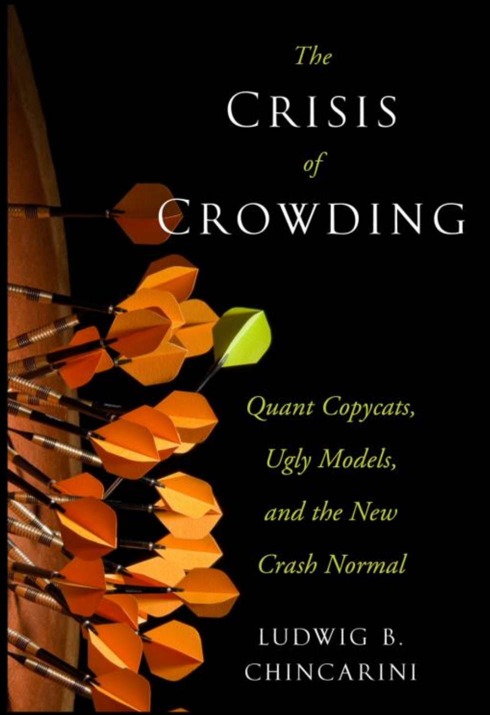


Crowding & the Future of Active Management Panel



November 6, 2019

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University of San Francisco

United States Commodity Fund Investments

UBS – Quantitative Investment Conference – Surfing the Crowd

November 6 & 7, New York, NY

- Chair: Russ Wermers
- Paul Winters
- Ludwig Chincarini
- Adam Parker

Summary

- The panel discussed many important issues and had a dynamic debate. Some of those questions and my particular responses are contained within.

Panel Questions

1. Much academic research has been generated on modeling the drivers of stock and bond returns over the past few decades--both in terms of systematic risk factors and the impact of macroeconomic factors. **Has this research been overused--based on the idea that much of it may have been data-mined?**

Panel Questions

Table 4. Return Degradation after Smart Beta Index Launch and Factor Publication, US (Jan 1967–Aug 2016)

Panel A. *Smart Beta Strategies: Before and After Index Launch*

Annualized Results	Fundamental Index	Equal Weight	Low-Vol Index	FTSE RAFI Low Vol	Quality Index	Dividend Index	Risk Efficient	Maximum Diversification	Average
Year Launched	Nov-05	Jan-03	Feb-11	Apr-13	Dec-12	Nov-03	Jan-10	Nov-11	
Before Launch	2.0%	1.3%	1.2%	2.2%	0.4%	2.9%	2.7%	1.6%	1.8%
After Launch	0.4%	2.3%	2.1%	0.1%	0.1%	1.3%	0.9%	4.1%	1.4%
Difference	-1.6%	1.0%	0.9%	-2.1%	-0.4%	-1.6%	-1.9%	2.5%	-0.4%

Panel B. *Factors: Before and After Publication*

Annualized Results	Value (Blend)	Value (B/P)	Momentum	Size	Illiquidity	Low Beta	Profitability	Investment	Average
Year Published	1977	1977	1993	1981	2002	1975	2013	2004	
Before Publication	9.8%	9.1%	5.4%	7.0%	2.5%	7.4%	1.2%	3.5%	5.8%
After Publication	2.3%	1.4%	3.7%	0.8%	5.0%	2.1%	5.0%	-1.0%	2.4%
Difference	-7.5%	-7.8%	-1.8%	-6.2%	2.5%	-5.4%	3.8%	-4.5%	-3.3%

Source: Research Affiliates, LLC, using CRSP/Compustat and Worldscope/Datastream data.

- Hard question. However, there is a paper showing the decay in certain factor returns after publication of research and after being launched in an ETF. RAI published some results.
- Story: Fischer Black in his office
- Papers – p-value misinterpretation. Ho, Zue Zhang Replicating Anomalies (2017) & Harvey,Liu, and Zhu (2016)

Panel Questions

2. Firms such as Research Affiliates, AQR, Blackrock, and Dimensional Fund Advisors have greatly reduced the costs of investing in "factors". To what degree might we attribute crowding to the success of these firms in marketing their products?

- Possibly, but would have happened anyway.
- Study on Low Vol suggests its crowded, but a paper recently done in JIC shows that net effects of AUM might offset each other and thus not be troubling. Definitely need more measures and something like a crowding metric continuously computed for these type of flows – maybe as percentage of other asset categories, net of exposures.

Panel Questions

3. Are there **reasonably reliable indicators** of when crowding has significantly dislocated a segment of the market? For example, Research Affiliates proposes firm fundamentals as indicating that crowding has overly affected prices. A counterpoint, however, might be that the crowd is often smart, and indicators of fundamentals are inherently flawed.

-

Panel Questions

- This is a neat approach. I actually discussed this in a footnote in The Crisis of Crowding. First, I think it's a start. Second, they actually show that it works. Some people disagree with it, but it's a start.
- Crowding right now has two main approaches – holdings based (hard to do) and return or valuation based. This is the 2^{nd} measure.
- Even LTCM was very smart, but the key is that some strategies have saturation points and too much flow into them leads to a potential quick breakdown.
- I would look at return measures and valuation measures versus HISTORY. Also, I would try to get holdings based approaches, where holdings in dollar value are compared to liquidity (e.g. ADTV) or the assets on the other side of the market. For example, if you had to unwind these type of positions, how big are the people on the other side to BUY these positions? Or are they not even there? What's that ratio?
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Panel Questions

4. Do you have any opinions on which sectors/asset classes might be exhibiting the biggest signs of crowding now?

- You have to really be running the numbers to know what is crowded and measuring accurately.
- Some banks think that financials, consumer discretionary are crowded on SHORT side.
- Some think US government bonds are crowded and bonds of other countries – i.e. negative interest rates – why DEMAND for bonds>>SUPPLY of bonds. Isn't this crazy?
- Passive investing – maybe, not yet?

Panel Questions

5. With the pressure of active investment managers to keep up with their peers over the short-run, is "bad-crowding" an inherent part of our markets? How can an investment manager overcome these pressures?

- I referenced in my talk papers showing copycat behavior of successful investors.
- I don't think it's inherent, it depends on the horizon and the goals. Remember Warren Buffett from 1999-2001 or so, he was down 40%.
- And if you must follow or die, make sure you measure crowding so you know when "too much" risk is on the table.
- Horizon matters as well and is underresearched. As does your liquidity lines and your customer's understanding.

Audience Discussion

- Question : Do you think there is a role for regulation in crowding?

Thank you

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