Millesime IS Treasure Hunter

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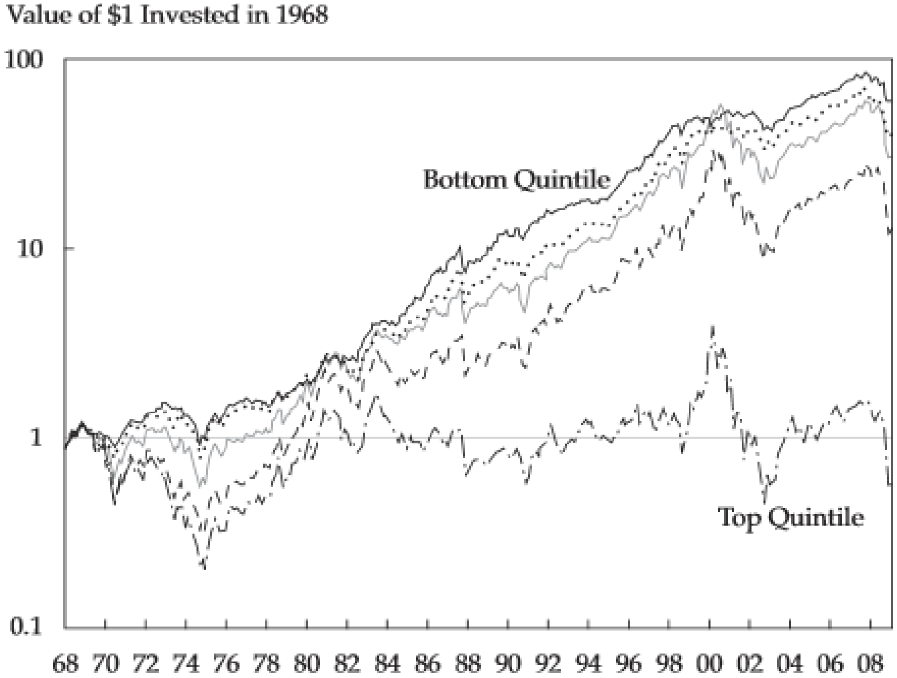
Low volatility anomaly

Investors are not rewarded for bearing risk: low risk stocks tend to outperform their risky peers.

Malcolm Baker, Brendan Bradley, and Jeffrey Wurgler – authors of the study ["Benchmarks as Limits to Arbitrage: Understanding the Low-Volatility Anomaly"]-provide evidence that the preference for high-volatility stocks derives from the bias that afflict the individual investor.

Returns by Volatility and Beta Quintile, January 1968–December 2008

A. All Stocks, Volatility Quintiles



Behavioral explanation

Preference for lotteries

Investors have a preference for investments that exhibit the same characteristics as lottery tickets: there is a small chance of its doubling or tripling in value in a short period and a much larger chance of its declining in value.

Representativeness

Representativeness bias causes people to over-weight recent information and deemphasize base rates or priors. This is best illustrated by investors seeking a fund in which to invest, and basing their decision on the fund's most recent performance rather than covering a longer duration, especially during bear markets.

Overconfidence

Overconfident investors place too much faith in their ability to process information. Investors take bad bets because they fail to realize that they are at an informational disadvantage and they trade more frequently, which leads to excessive trading volume. Overconfidence can cause investors to underreact to new information.

Because human nature doesn’t change, there doesn’t seem to be any reason to believe that the low-volatility anomaly will not persist.

Risk-based asset allocation: a first step in the good direction

Minimum variance, Equal Risk Contributions (*ERC*), Risk Parity allocation allocate weights of a portfolio depending on the volatility and diversification value of each asset. Fundamentally **those techniques completely ignore expected returns** and focus only on risk.

Much of the anomaly can be explained by **the poor performance of high-volatility stocks**, not the outperformance of low-volatility stocks.

Millesime IS has created a new framework for asset allocation, **introducing expected returns into risk-based methods**, a kind of Sharpe Parity.

The Treasure Hunter detects the most valuable and the fake gems in stock markets taking into account risk, correlations AND expected returns.

Long only (an illustration)

	Euro Stoxx	Long only
CAGR	1.8%	7.9%
Volatility	21.9%	18.8%
Sharpe	0.08	0.42
MDD	-62%	-57%

Long short (an illustration)

	Euro Stoxx	Long-Short
CAGR	1.8%	4.6%
Volatility	21.9%	7.1%
Sharpe	0.08	0.65
MDD	-62%	-12%

Available markets

Large Caps:

- Australia
- Brazil
- Canada
- Chile
- China-A
- China-B
- Denmark
- Euro area (Euro Stoxx 50)
- France (Cac 40)
- Germany (Dax)
- Korea (Kospi 200)
- Malaysia
- India
- Indonesia
- Japan (Topix 100)
- Mexico
- Russia
- Poland
- Singapore
- South Africa
- Spain
- Sweden
- Swiss
- Taiwan
- Thailand
- Turkey
- UK (FTSE 100)
- US (S&P 500)
- US (Nasdaq 100)

Small Caps:

- Euro area
- France
- Japan
- UK
- US

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