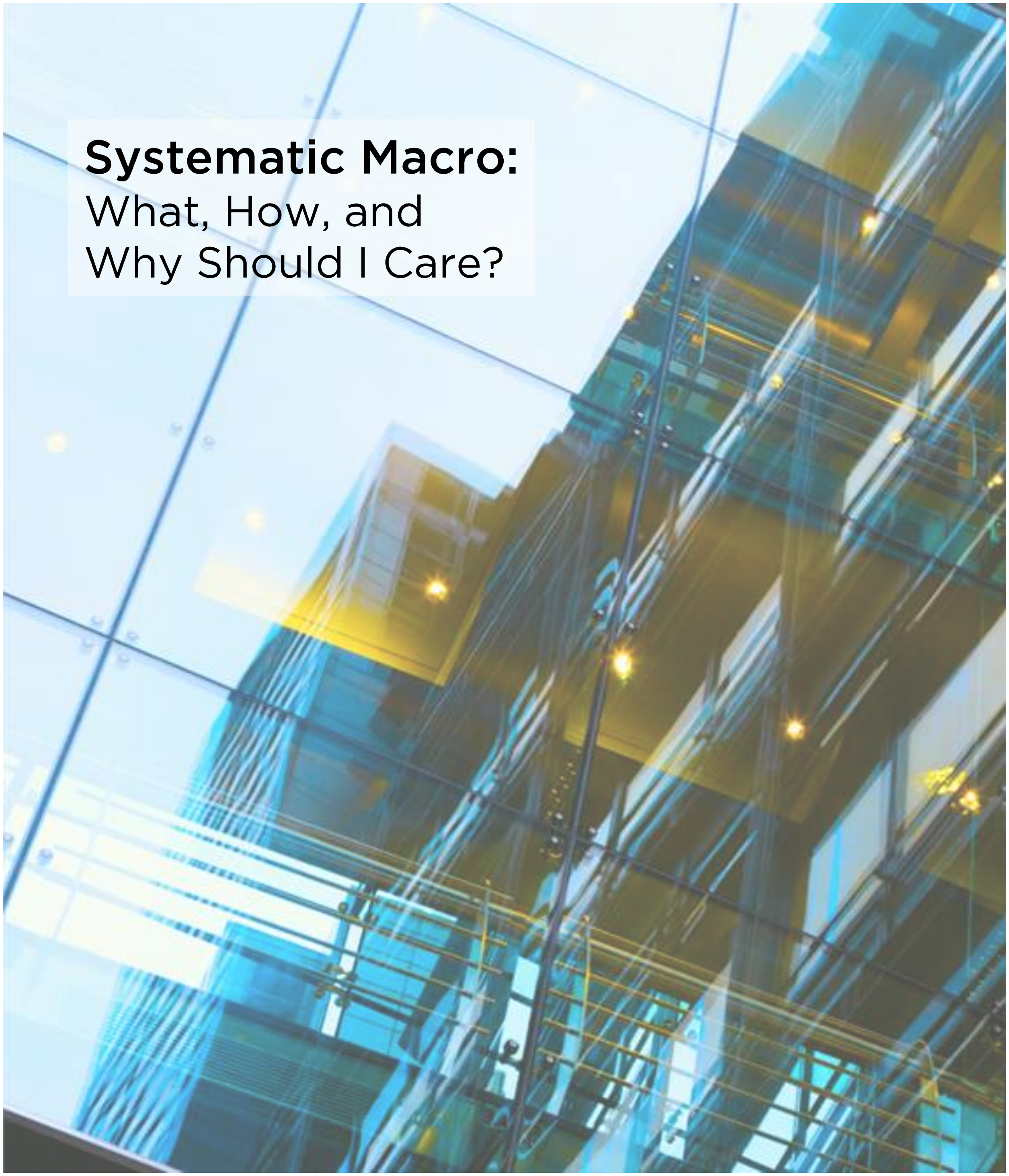
Systematic Macro:
What, How, and Why Should I Care?



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Preface

This paper will take an investor's view of Systematic Macro. We will:

- describe the investment process,
- explain how the strategy generates returns,
- discuss three beneficial traits of those returns, and
- how those return traits may benefit investors' overall portfolios through greater compounded gains over time.

What Is Systematic Macro?

Global Macro practitioners can be divided into two camps: discretionary and systematic. Discretionary practioners develop a top-down macroeconomic view and engage in concentrated positions based on discretionary assessments of fundamental data such as GDP, exchange rates, inflation, debt levels, and supply-demand dynamics.

By comparison, practioners of Systematic Global Macro (aka Systematic Macro) analyze price, economic, and market structure data using quantitative models to determine entry, exit and sizing decisions. Colloquially, a major branch of these managers are also known as CTAs, commodity trading advisors, or managed futures managers.

How Does Systematic Macro Generate Returns?

Returns are fueled by large macroeconomic drivers and the capital flows they trigger among the global asset classes traded. Drivers include things like global supply-and-demand, behavioral finance, monetary policy, economic growth differentials, and long-term interest rates played out across global equities, global currencies and commodity markets like softs, energies and metals.

Diversification and adaptability are two common traits of Systematic Macro. As a systematic strategy, managers consume a constant stream of market price data and other statistical variations. Positions are constantly adjusting in direction (long or short), conviction waxes and wanes in the form of position sizing, and the allocation mix among all positions is constantly balanced and risk managed.

Whereas traditional investors often associate volatility with unwelcome investment risk, volatility is often a driver of performance for Systematic Macro. This is because volatile conditions often produce price trends and relative mispricings between similar assets, two opportunities that Systematic Macro strategies seek to exploit. Moreover, even down-trending markets can be a source of return. Systematic Macro is agnostic to directionality given its ability to adopt short positioning, profiting even during the Global Financial Crisis.

Because of the strategy's uncommon breadth (four distinct sectors and often 100+ markets), strategy diversity, adaptability to changing market conditions, bidirectionality (i.e., long and short), and perhaps most importantly, unique underlying macroeconomic return drivers, it is little wonder that Systematic Macro has a zero long-term correlation to traditional equity and fixed income investments. Simply stated, Systematic Macro is objectively shown to be a *diversifying investment*.

Why Should I Care?

But just being *diversifying* isn't compelling to many. Low correlation is difficult to see and hold, and investors rightly care the most about improving their compounded total portfolio returns.

But could Systematic Macro do both? Could Systematic Macro be both diversifying and contribute gains when needed?

The answer is yes, and we will examine this next.

The Three Beneficial Traits of Systematic Global Macro

1. Large protracted equity drawdown coverage – Crisis Alpha
2. Periodic equity correction coverage
3. Compounded wealth benefits for investors with an enduring allocation to Systematic Macro over time

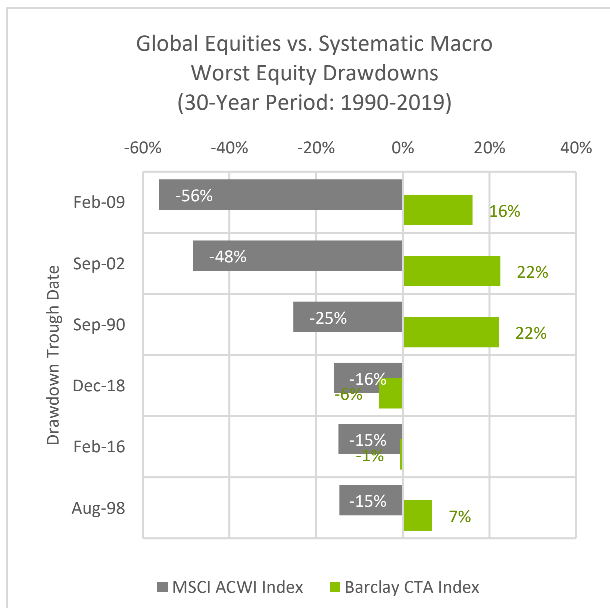
1) Large protracted equity drawdown coverage – Crisis Alpha

Systematic Macro is perhaps best known for its historical ability to deliver positive performance during severe, protracted equity market drawdowns, aka "crisis alpha." And now we can understand why. As explained, the volatility that often accompanies these periods also creates trending (often down-trending) and mispricing opportunities for Systematic Macro.

So is this "crisis alpha" reputation deserved?

The chart to the right highlights the six largest global equity drawdown periods. Gray bars measure global equity performance from the start of the drawdown through the trough of performance (i.e., max drawdown), while green bars represent Systematic Macro performance over the equivalent period.

These results show strong positive performance during the three most severe drawdowns, and slightly positive to muted performance for the remaining periods – evidence supportive of the "crisis alpha" claim.

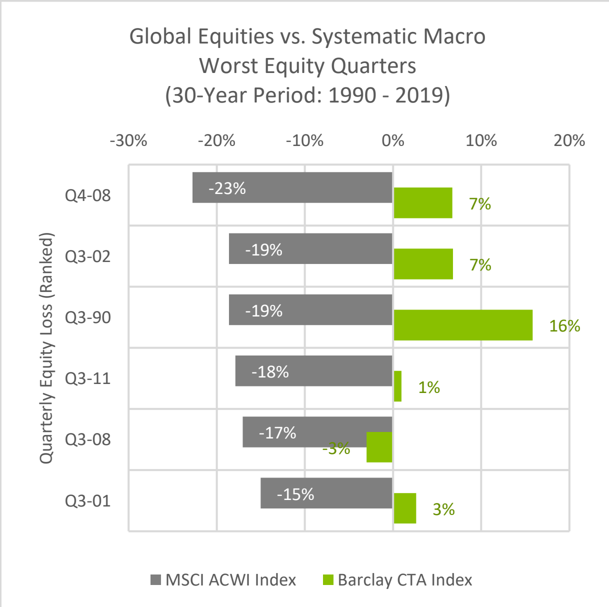


PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.

2) Periodic equity correction coverage

While large crises such as those above are often the ones investors most readily recall, more frequent and shorter equity correction periods are also corrosive to investors' portfolios over time.

Distinguishing between these two types of coverage periods is very important from an investor allocation point of view. Why? Because if one associates Systematic Macro solely with protection against protracted Bear markets (i.e., "crisis alpha"), they are likely to consider Systematic Macro as a *tactical allocation* chosen only when the investor believes the economic growth cycle is nearing its peak.



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If, however, Systematic Macro can assist with shorter timeframe market corrections across the economic cycle, this trait would suggest that Systematic Macro could be a worthy *perennial allocation* in an investor's portfolio.

So, does Systematic Macro meet the test for offsetting shorter duration equity corrections too?

To assess, we first must decide how to define a short-term equity correction. These periods could vary over a variety of lengths and we chose to simply identify the worst performing calendar quarters over the last 30 years.

The results appear to the left, and they too are supportive of the contention that Systematic Macro has historically guarded against these shorter duration equity correction periods as well.

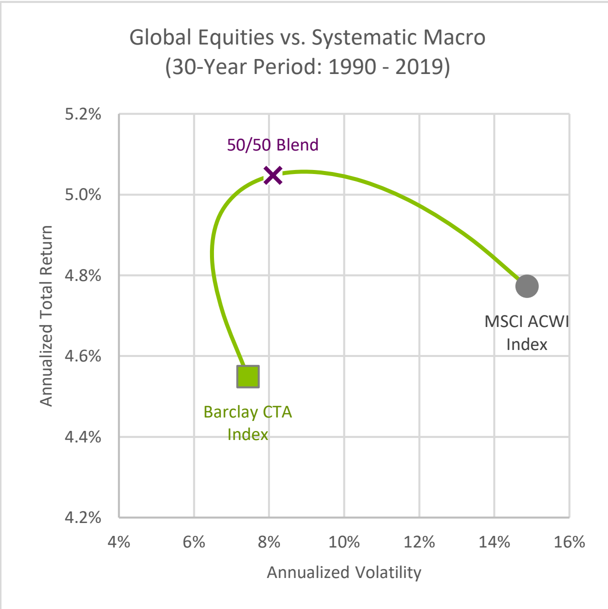
3) Compounded wealth benefits for investors with an enduring allocation to Systematic Macro over time

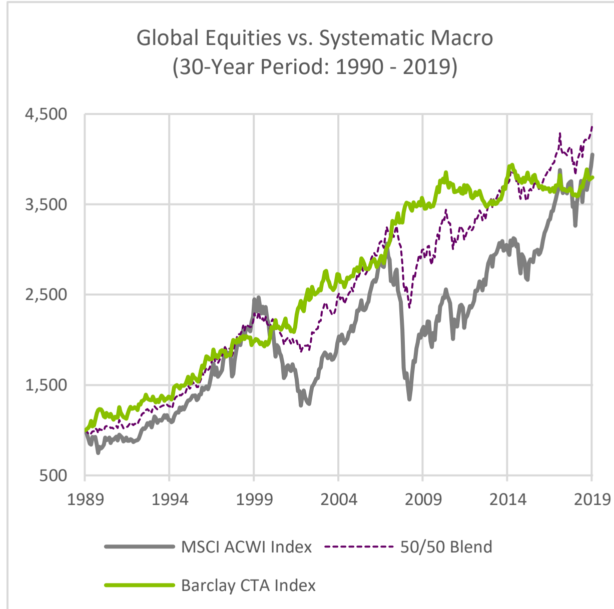
By this point we have established that Systematic Macro is diversifying, that it demonstrates crisis alpha during protracted equity drawdowns, and even episodic alpha during shorter duration equity correction periods.

So what should an investor conclude? These attributes are interesting, but do they contribute to greater overall compounded portfolio gains for investors?

Once again, we looked to our 30-year analysis for answers from both an efficient frontier view as well as from a compounded growth vantage point.

One caveat is that the starting point for any such analysis will always play an influential role, particularly when comparing any strategy against an equity index with the kinds of extreme bull/bear cyclicity as can be seen with the MSCI ACWI Index. That said, we think the results are worthy of examination given its 30-year span and the fact that it covers 2-1/2 economic cycles.





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The efficient frontier chart (left-side) shows that the Systematic Macro index delivered roughly an equity-equivalent annualized rate of return (4.55% vs. 4.77% for global equities) with approximately half the volatility of the global equity index (7.44% vs. 14.87%). And these traits are also on display in the right-side compounded growth chart with Systematic Macro delivering a smoother compounded growth line (green) than that of global equities (gray). Most notably one can see that Systematic Macro did not just avoid the performance avalanches in equities during the early 2000s and 2008-2009, but sustained performance gains through these periods.

Lastly, as an additional point of interest we've plotted a 50/50 blend portfolio (purple) to answer our most important question which is whether Systematic Macro improves the compounded returns of the investor's portfolio, in this case, a portfolio of global equities. This combination yields even higher annualized returns of 5.05%, harnessing both the smoothing qualities of Systematic Macro and the positive bull market cyclicity afforded by the equity markets – a very complementary pairing.

Endnotes

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