

A photograph of classical stone columns, showing the fluted shafts and the base of one column in the foreground. The image is in black and white, with a soft focus.

Alternative Investment Analyst Review

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IR&M MOMENTUM MONITOR

IR&M Momentum Monitor

Alexander Ineichen, CAIA, CFA, FRM



IR&M Momentum Monitor

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Ineichen Research & Management AG

1. Introducing MOM

Spotting change is important. There are essentially two approaches to change: having a guess, or measuring it in a systematic fashion with an applicable methodology. The latter is robust, the former is not. Momentum can be perceived as a philosophy. We herein recommend it as a risk management tool, rather than a philosophy. If risk is defined as “exposure to change,” then one ought to spot the change.

2. Purpose

The aim of this article is to add some color to the IR&M Momentum Monitor (MOM). MOM seeks to improve the investor’s investment decisions. The idea behind monitoring prices and earnings (or anything else) is twofold: observation and discipline. A monitor allows regularly observing as well as regularly revisiting large amounts of data in a systematic fashion. MOM can also add discipline to an investment process. MOM’s “signal” is systematic—essentially the opposite of someone’s forecast.

The idea is not to forecast the future, but to assess the present and decide whether an investment is in a favorable environment or an unfavorable one. Essentially deciding, literally, whether it’s green for “go” or red for “don’t go”. MOM’s thumb is either up or down, so to speak.

3. Momentum as a Risk Measure

Risk management is the main task of the absolute returns investor. It is losses, especially large ones that kill the rate at which capital compounds. It is the drawdown measure that is important, not volatility. Volatility by itself can be a good thing. Equities are more volatile than bonds and outperform bonds most of the time. Volatility can be both good and bad, while drawdowns are unambiguously bad.

The MOM was designed to assist risk takers and investment managers in their risk management. It provides signals that can initiate a thought process. The MOM is not the Holy Grail of finance, unfortunately. However, it is designed to quite literally spot change. If risk is defined “exposure to change,” then pointing it out seems important and relevant. MOM spots change systematically. The advantage is that MOM signals when the environment changes from headwind to tailwind or vice versa reasonably early and in a systematic fashion. One therefore ought to listen to MOM. The factual

knowledge should then help improve decision making. It can help with tactical asset allocation, position sizing, allocating new funds, hedging, and other facets of the investment process.

The Momentum idea can also be applied to earnings estimates. Earnings estimates by themselves are forecasts. An earnings estimate might or might not turn out to be correct. It’s a forecast. However, the trend in consensus earnings forecasts is a fact, not a forecast. It can be measured objectively. Relying on facts that can be measured objectively adds to the robustness of the investment decision-making process.

4. Bottom Line

Change matters much more than the current state of things. Stocks in Russia, India, and China are trading at single digit private equity (PE) ratios. That’s a fact, it’s the status quo. However, it could well be that in three, four, or five years these stocks will still be trading at single digit PEs; who knows? We believe change to be more important; hence the focus on momentum. Misusing Newton’s laws, it means a catalyst is required to move from a static state to a dynamic one. Predicting these catalysts - the butterfly wing flaps that can set off tornadoes - is difficult. Preferably, one ought to focus on movements where the catalyst has already occurred, (i.e., where the motion is already taking place). Hence the focus on measured change and motion, rather than status quo, that might or might not change soon. MOM can do all that.

IR&M Momentum Monitor

By Alexander Ineichen, CFA, CAIA, FRM; www.ineichen-rm.com



March 2014

Price Momentum

Earnings Momentum

Calendar Week:	Medium-term				Long-term				Medium-term				Long-term			
	9	10	11	12	9	10	11	12	9	10	11	12	9	10	11	12
Equities by region																
MSCI World	3	4	5	6	81	82	83	84	10	11	12	13	56	57	58	59
Europe (STOXX 600)	11	12	-1	-2	82	83	84	85	-3	-4	-5	-6	-1	-2	-3	-4
MSCI Emerging Markets	-12	-13	-14	-15	-5	-6	-7	-8	-16	-17	-18	-19	-35	-36	-37	-38
MSCI Asia Pacific ex Japan	1	2	3	-1	2	3	-1	-2	-14	-15	1	2	17	18	19	20
Equities by country																
USA (S&P 500)	3	4	5	6	110	111	112	113	65	66	67	68	104	105	106	107
Canada (SPTSX 60)	33	34	35	36	27	28	29	30	-10	-11	1	2	-2	-3	-4	-5
Brazil (Bovespa)	-15	-16	-17	-18	-9	-10	-11	-12	18	-1	-2	-3	11	12	13	14
France (CAC 40)	3	4	5	6	81	82	83	84	-6	-7	-8	-9	-128	-129	-130	-131
Germany (DAX 30)	34	35	-1	-2	83	84	85	86	3	4	5	6	45	46	47	48
Italy (FTSE MIB)	10	11	12	13	27	28	29	30	-2	-3	-4	-5	5	6	7	8
Switzerland (SMI)	10	11	-1	-2	85	86	87	88	-4	-5	-6	-7	-6	-7	-8	-9
UK (FTSE100)	2	3	-1	-2	81	82	83	84	-32	-33	-34	-35	-26	-27	-28	-29
Australia (S&P/ASX)	3	4	5	6	79	80	81	82	19	20	21	22	47	48	49	50
China (Shanghai Composite)	-1	-2	-3	-4	-8	-9	-10	-11	14	15	16	17	51	52	53	54
Hong Kong (Hang Seng)	1	2	-1	-2	23	24	-1	-2	-1	-2	-3	-4	67	68	69	70
India (Nifty)	1	2	3	4	19	20	21	22	2	3	4	5	18	19	20	21
Japan (Nikkei 225)	-5	-6	-7	-8	64	65	66	67	15	16	17	18	53	54	55	56
South Korea (Kospi)	1	2	-1	-2	-2	-3	-4	-5	-8	-9	-10	-11	-39	-40	-41	-42
Bonds																
Barclays Global Aggregate	7	8	9	10	18	19	20	21	18	19	20	21	18	19	20	21
Barclays Global HY	25	26	27	28	26	27	28	29	26	27	28	29	26	27	28	29
Barclays Euro Aggregate	23	24	25	26	18	19	20	21	18	19	20	21	18	19	20	21
Barclays Asia Pacific Aggregate	25	26	27	28	21	22	23	24	21	22	23	24	21	22	23	24
Barclays Global Emerging Markets	4	5	6	7	12	13	14	15	12	13	14	15	12	13	14	15
Barclays US Aggregate	8	9	10	11	7	8	9	10	7	8	9	10	7	8	9	10
Barclays US Corporate HY	25	26	27	28	114	115	116	117	114	115	116	117	114	115	116	117
Hedge Funds																
HFRX Global Hedge Funds	25	26	27	28	79	80	81	82	79	80	81	82	79	80	81	82
HFRX Macro/CTA	-4	-5	-6	-7	-36	-37	-38	-39	-36	-37	-38	-39	-36	-37	-38	-39
HFRX Equity Hedge	24	25	26	27	79	80	81	82	79	80	81	82	79	80	81	82
HFRX Event Driven	66	67	68	69	78	79	80	81	78	79	80	81	78	79	80	81
HFRX Relative Value Arbitrage	25	26	27	28	16	17	18	19	16	17	18	19	16	17	18	19
HFRX Fixed Income - Credit	87	88	89	90	144	145	146	147	144	145	146	147	144	145	146	147
Commodities																
Thomson Reuters/Jefferies CRB	6	7	8	9	2	3	4	5	2	3	4	5	2	3	4	5
Gold (Comex)	4	5	6	7	-55	-56	-57	1	-55	-56	-57	1	-55	-56	-57	1
Copper (Comex)	-5	-6	-7	-8	11	12	-1	-2	11	12	-1	-2	11	12	-1	-2
Oil (WTI)	5	6	7	8	-14	-15	-16	-17	-14	-15	-16	-17	-14	-15	-16	-17
FX																
USD (trade-weighted, DXY)	-3	-4	-5	-6	-24	-25	-26	-27	-24	-25	-26	-27	-24	-25	-26	-27
EURUSD	3	4	5	6	32	33	34	35	32	33	34	35	32	33	34	35
JPYUSD	5	-1	1	2	-66	-67	-68	-69	-66	-67	-68	-69	-66	-67	-68	-69
Central banks' balance sheets																
Fed balance sheet	72	73	74	75	64	65	66	67	64	65	66	67	64	65	66	67
ECB balance sheet	-74	-75	-76	-77	-63	-64	-65	-66	-63	-64	-65	-66	-63	-64	-65	-66
BoJ balance sheet	95	96	97	98	147	148	149	150	147	148	149	150	147	148	149	150
BoE balance sheet	4	5	6	7	-43	-44	-45	-46	-43	-44	-45	-46	-43	-44	-45	-46

Commentary

Many equity markets shown here are in a long-term bull market. Emerging markets turned negative in late 2013.

Earnings momentum for the MSCI World and S&P 500 has been positive for a while.

Momentum in bonds is mostly positive.

Momentum in hedge funds has been positive for more than a year.

Commodities have turned and are now rising. The Fed's balance sheet is expanding merrily.

Tutorial

The momentum numbers count the weeks of a trend based on moving averages. Green marks a positive trend, red a negative one. Example: In week 12, the S&P has been in a long-term bullish trend for 113 weeks. See www.ineichen-rm.com for more information and/or trial issue.

Purpose

The momentum monitor was designed to help investors with risk management, asset allocation, and position sizing. Tail events do not always happen out of the blue. They often occur when momentum is negative. Negative momentum makes hedging more important and suggests position sizing should be more conservative. In a bull market one ought to be long or flat but not short. In a bear market one ought to be short or flat but not long.

Source: IR&M, Bloomberg. Notes: Medium-term based on exponentially weighted average over 3 and 10 weeks. Long-term based on simply weighted average over 10 and 40 weeks. Earnings momentum is based on 12-month forward consensus EPS estimates.

Author Bio



Alexander Ineichen is founder of Ineichen Research and Management AG, a research firm founded in October 2009 focusing on risk management, absolute returns, and thematic investing.

Alexander started his financial career in derivatives brokerage and origination of risk management products at Swiss Bank Corporation in 1988. From 1991 to 2005 he had various research functions within UBS Investment Bank in Zurich and London relating to equity derivatives, indices, capital flows, and alternative investments, since 2002 in the role of a Managing Director. From 2005 to 2008, he was a Senior Investment Officer with Alternative Investment Solutions, a fund of hedge funds within UBS Global Asset Management. In 2009, he was Head of Industry Research for the hedge fund platform at UBS Global Asset Management.

Alexander is the author of the two publications “In Search of Alpha: Investing in Hedge Funds” (October 2000) and “The Search for Alpha Continues: Do Fund of Hedge Funds Add Value?” (September 2001). These two documents were the most-often printed research publications in the documented history of UBS. He is also author of “Absolute Returns: The Risk and Opportunities of Hedge Fund Investing” (Wiley Finance, October 2002) and “Asymmetric Returns: The Future of Active Asset Management” (Wiley Finance, November 2006). Alexander has also written several research pieces pertaining to equity derivatives and hedge funds including AIMA’s Roadmap to Hedge Funds (2008 and 2012), which has been translated into Chinese and was the most-often downloaded document from their website at the time.

Alexander holds a Bachelor of Science in Business Administration with Major in General Management from the University of Applied Sciences in Business Administration Zürich (HWZ) in Switzerland. Alexander also holds the Chartered Financial Analyst (CFA) and Chartered Alternative Investment Analyst (CAIA) designations and is a certified Financial Risk Manager (FRM). He is on the Board of Directors of the CAIA Association and is a member of the AIMA Research Committee.