RPM EDUCATIONAL
4.

Long Equities! Crisis Alpha?

RPM *investments*
DIFFERENT MOVES.

LONG EQUITIES! CRISIS ALPHA?

Key point: When an equity crisis sets in, CTAs are typically long equities and, thus, will suffer losses from this sector. These losses have historically been offset by profits in other sectors and after a week into a crisis period, CTAs have on average started to deliver net returns. This "Crisis Alpha"-characteristic is more pronounced the longer and deeper the equity downturn continues.

CRISIS ALPHA? - AREN'T CTAs LONG EQUITIES?

Investors are faced with a bit of a conundrum these days. Many worry over their equity exposure and are looking to invest, or to increase their investments, in CTAs as a source of Crisis Alpha. At the same time, CTAs are long equity markets, as this sector has been the only source of profit this year. Investors are concerned that CTAs would suffer losses in these markets if they make a sudden downturn which would make the situation worse rather than improving it. Are these worries justified? Obviously, no one knows how the future will play out but we can always turn to history for potential lessons to be learned. We choose to look at the recent 15 years or so and distinguish 12 equity crisis periods[1] as listed in Table 1:

Crisis Name	Crisis Period	Equity Return[2]	CTA Return[3]
Enron and 9/11	Aug-01 to Sep-01	-13.6%	6.3%
Accounting Scandal	Jun-02 to Sep-02	-23.2%	24.0%
2nd Gulf War	Dec-02 to Feb-03	-9.3%	19.1%
Sub-prime	Nov-07 to Mar-08	-13.7%	9.7%
Credit Crunch	Jun-08 to Feb-09	-49.8%	7.2%
Obama's Bank Speech	Jan-10	-4.1%	-3.8%
Flash Crash	May-10	-9.5%	-4.0%
Euro Debt I	Jul-11 to Sep-11	-16.5%	3.5%
Euro Debt II	May-12	-8.5%	2.4%
Renminbi Devaluation	Aug-15	-6.6%	-2.8%
Oil Glut	Jan-16 to Feb-16	-6.6%	7.4%
Brexit	Jun-16	-1.1%	4.2%

TABLE 1 - RECENT EQUITY CRISIS
Source: RPM, BarclayHedge, Bloomberg

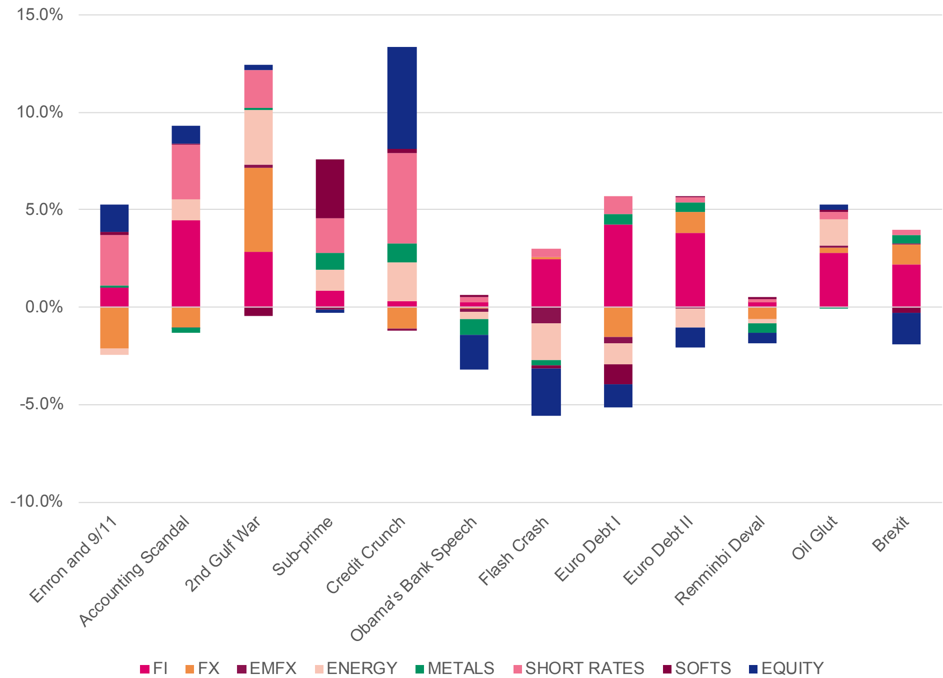
1. Crisis periods defined according to a contextual definition meaning a fundamentally identified period around a month, or months, in which the MSCI World Equity index was negative -4% or more, including Brexit for the sake of completion.
2. Equity = MSCI World Total Return
3. CTA = DJCS Managed Futures Index

SECTOR RETURNS DURING CRISES

Figure 1 shows sector contributions to CTA returns[4] during each crisis. The first observation is that the Crisis Alpha characteristic of CTA returns is NOT just coming from (being short) equities. Sector contributions look quite different between the different crisis periods. We also see that for all shorter crisis periods, the equity sector contributed negatively. In some of these periods this negative contribution was quite substantial.

FIGURE 1 - SECTOR CONTRIBUTION DURING CRISIS

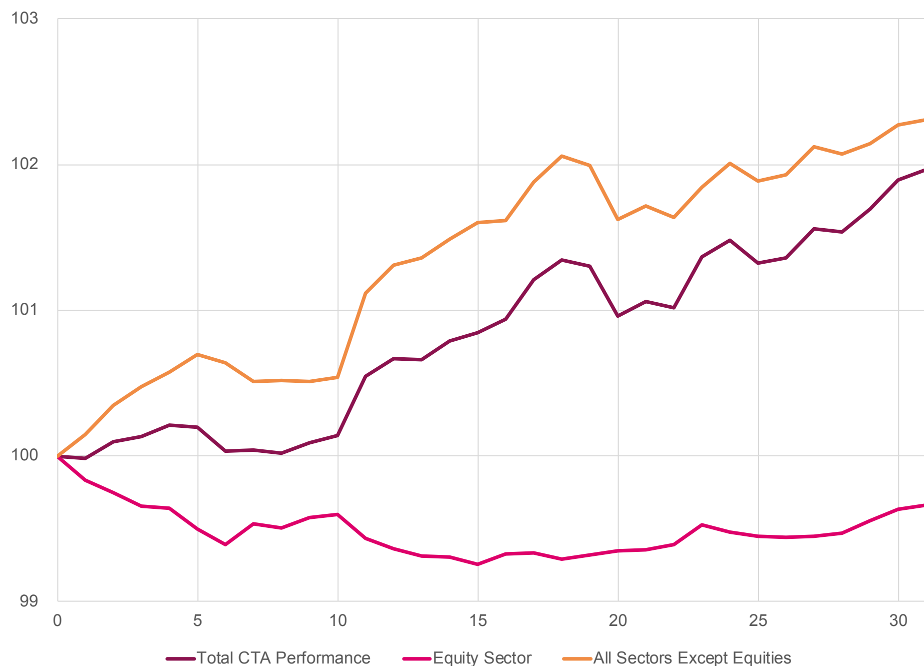
Profits and losses from different market sectors during equity crises for the RPM USD Composite.
Source: RPM



So, what happens in the initial stages of an equity crisis? In Figure 2 we focus on the first 30 days since the onset of each crisis. We look at daily indices of total CTA returns, equity contribution, and contributions from all non-equity sectors, averaged across crisis periods.

FIGURE 2 -EQUITY AND NON-EQUITY CONTRIBUTION DURING INITIAL CRISIS

Daily contribution indices for the RPM USD Composite during the first 30 trading days.
Source: RPM

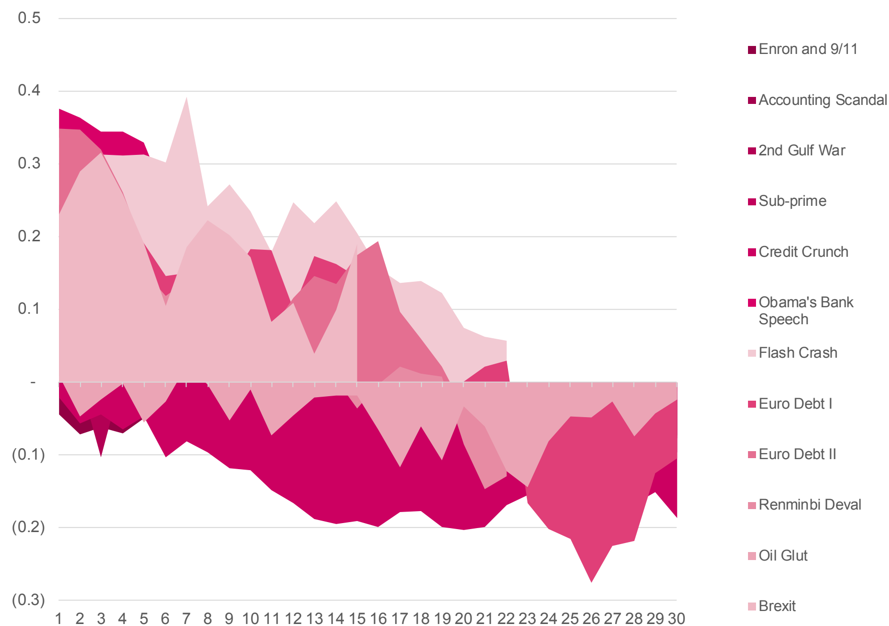


4. Using contributions from the RPM USD Composite

We note that CTA returns are on average flat for the first week or so. The positive returns from non-equity sectors are offset by negative equity returns. As equity returns flatten out, and eventually turn positive, we see the Crisis Alpha-type returns from CTAs picking up. Why is this? In Figure 3 we look at the equity exposure for the first 30 days of each crisis. In the majority of crisis scenarios, CTAs are initially long equities. This is not unexpected since crisis periods usually occur after relatively stable equity bull market periods. The exceptions, the Credit Crunch and Enron & 9/11 crises, come shortly after another crisis period which means that CTAs are still short equities and can profit from that position going forward. The interesting observation is that at the onset of the crisis, CTAs start to reduce their equity positions and after 20 days or so they have on average turned their positions around. Note that the individual managers have quite diverse position profiles, representing different strategies such trend-following, liquid macro and short-term across holding time frames ranging from intraday up to 1-2 months. However, the aggregated pattern is consistent and if the crisis period continues and deepens beyond the first month, the managers turn their positions around and can profit also from the equity sector.

FIGURE 3 - EQUITY EXPOSURE DURING CRISIS

Daily equity positions for the RPM USD Composite during the first 30 trading days in each crisis period. Source: RPM



Before the above graphs tempt anyone to try to time the allocation given the equity holdings of CTAs, we'll remind you that the analysis is based on crisis periods that are identified post-factum. There are several 20 day periods of negative equity returns that do not constitute the initial stages of a prolonged and deep equity crisis. Trying to predict the crisis periods in the initial stage to time the CTA allocation is as hard as trying to predict the equity market itself.

Will rebalancing the portfolio during an equity crisis deteriorate the contribution from CTAs? In our research, we find that rebalancing more frequently than yearly reduces the positive effects of CTAs slightly but the old adage, that long-term asset allocation, not rebalancing frequency, is the major determinant of risk and return for a given portfolio, still holds.

In conclusion, when you invest in CTAs you don't buy into a market view or position. You buy into the CTAs innate ability to react and adapt to market events in a systematic, disciplined, and relatively unconstrained way. These abilities are particularly important in periods when markets are driven by fear and emotions. Such a period will come again, sooner or later...

We are more than happy to receive feedback, questions, comments and to engage in further discussions regarding CTAs in general. Please reach out to us on:

Mikael Stenbom - CEO
Phone: + 46 8 440 69 00
E-mail: mikael.stenbom@rpm.se

Johanne Schordin - Investor Relations
Phone: + 46 8 440 69 31
E-mail: johanne.schordin@rpm.se

Per Ivarsson - Head of Investment Management
E-mail: Per.ivarsson@rpm.se

Alexander Mende, PhD, Head of Research
E-mail: alexander.mende@rpm.se

IMPORTANT INFORMATION: This material is issued by RPM Risk & Portfolio Management AB ("we" and/or "us"). We are registered in Sweden with company number 556254-9039 and have our office at Brahegatan 2, SE-114 37 Stockholm, Sweden. We are authorised and regulated by Finansinspektionen (the Swedish Financial Supervisory Authority).

This material is issued by us only to and/or is directed only at persons who are professional clients or eligible counterparties. To the extent that investments and/or investment services are referred to herein, they are only available to such persons and other persons should not act or rely on the information contained herein. In particular, any investments and investment services are not intended for persons who are retail clients and will not be made available to retail clients. The information contained herein is intended only for the person or entity to which it is directed and may contain confidential and/or privileged material. Any retransmission, dissemination or other unauthorised use of this information by any person or entity is strictly prohibited. If you have received this communication in error, please contact the sender immediately and delete this material in its entirety.

This material contains general information about us and is not intended to constitute an offer or solicitation of an investment or service in any jurisdiction in which such an offer or solicitation is not authorised or to any person to whom it is unlawful to make such an offer or solicitation. However, the distribution of information contained in this material in certain countries may be restricted by law and persons are required to inform themselves and to comply with any such restrictions. Persons interested in receiving further information about any investment or service should inform themselves as to: (i) the legal requirements within the countries of their nationality, residence, ordinary residence or domicile; (ii) any foreign exchange control requirement which they might encounter; and (iii) the income tax and other tax consequences which might be relevant. Nothing contained herein constitutes investment, legal, tax or other advice, nor is it to be relied upon when making investment or other decisions. You should obtain relevant and specific professional advice before making any decision to enter into an investment transaction. An application for shares in any investment fund to which we provide investment advisory services or any other service should only be made having read fully the relevant prospectus. It is your responsibility to use such prospectus and by making an application you will be deemed to represent that you have read such prospectus and agree to be bound by its contents.

This material may contain projections or other forward-looking statements. These forward-looking statements are based on our current expectations and beliefs about future events as of the date of this material. As with any projection or forecast, they are inherently susceptible to uncertainty and changes in circumstances, and we are under no obligation to, and expressly disclaims any obligation to, update or alter any forward-looking statements whether as a result of such changes, new information, subsequent events or otherwise.

The information contained herein is based on sources that we believe to be reliable but no representation or warranty, expressed or implied, is made as to its accuracy, completeness or correctness.

To the extent this material contains past performance information, past performance may not be repeated and should not be seen as a guide to future performance. The value of the investments and the income therefrom may go down as well as up and investors may not get back the original amount invested. Your capital could be at risk. You are not certain to make money from your investments and you may lose money. Exchange rates may cause the value of overseas investments and the income therefrom to rise and fall.

European SICAV Alliance

This material is not intended as and is not to be taken as an offer or solicitation to make an investment in European SICAV Alliance (the "Funds") in any jurisdiction in which such an offer or solicitation is not authorised or to any person to whom it is unlawful to make such an offer or solicitation. However, the distribution of information contained in this material in certain countries may be restricted by law and persons are required to inform themselves and to comply with any such restrictions. Persons interested in receiving further information about the Fund should inform themselves as to: (i) the legal requirements within the countries of their nationality, residence, ordinary residence or domicile; (ii) any foreign exchange control requirement which they might encounter; and (iii) the income tax and other tax consequences which might be relevant. Nothing contained herein constitutes investment, legal, tax or other advice, nor is it to be relied upon when making investment or other decisions. You should obtain relevant and specific professional advice before making any decision to enter into an investment transaction. We do not provide investment advice to, nor receives and transmits orders from, investors in the Funds nor does RPM carry on any other activities for investors in the Funds that constitute investment services and activities or ancillary services pursuant to the Markets in Financial Instruments Directive. An application for shares in the Funds or any other investment funds to which we provide investment advisory services or any other service should only be made having read fully the relevant Prospectus. It is your responsibility to use such Prospectus and by making an application you will be deemed to represent that you have read such Prospectus and agree to be bound by its contents.

With respect to Shares distributed in or from Switzerland:
The Representative in Switzerland is First Independent Fund Services Ltd. The prospectus, the articles and the annual reports are available to Qualifi ed Investors only free of charge from the Representative. In respect of the Shares distributed in and from Switzerland to Qualifi ed Investors, place of performance and jurisdiction is at the registered offi ce of the Representative. Paying Agent: NPB Neue Privat Bank AG, Limmatquai 1, 8022 Zurich.

With respect to Shares distributed in or from Austria:
NEITHER EUROPEAN SICAV ALLIANCE AS ALTERNATIVE INVESTMENT FUND (AIF) NOR RPM RISK & PORTFOLIO MANAGEMENT AB AS ALTERNATIVE INVESTMENT FUND MANAGER (AIFM) ARE SUBJECT TO SUPERVISION OF THE AUSTRIAN FINANCIAL MARKET AUTHORITY OR ANY OTHER AUSTRIAN AUTHORITY. WHILE THE AIF IS EXCLUSIVELY SUBJECT TO SUPERVISION OF THE COMMISSION DE SURVEILLANCE DU SECTEUR FINANCIER IN LUXEMBOURG (CSSF), THE AIFM IS EXCLUSIVELY SUBJECT TO SUPERVISION OF THE FINANSINSPEKTIONEN IN SWEDEN. NEITHER A PROSPECTUS, NOR ANY OTHER DOCUMENTS HAVE BEEN CHECKED BY THE AUSTRIAN FINANCIAL MARKET AUTHORITY OR ANY OTHER AUSTRIAN AUTHORITY. THE AUSTRIAN FINANCIAL MARKET AUTHORITY OR ANY OTHER AUSTRIAN AUTHORITY CAN NOT BE HELD RESPONSIBLE FOR THE ACCURACY OR COMPLETENESS OF THE SUBMITTED MARKETING INFORMATION.

The transactions in which the Funds will engage involve significant risks. No assurance can be given that investors in Funds will realize a profit on their investments. Moreover, investors may lose all or some of their investments. Because of the nature of the trading activities, the results of the Fund's operations may fluctuate from month to month and from period to period. Accordingly, investors should understand that the results of a particular period will not necessarily be indicative of results in future periods.

THIS MATERIAL IS NOT SUITABLE FOR US INVESTORS.

RPM *risk & portfolio management*

RPM Risk & Portfolio Management AB
PHONE +46 8 440 69 00 ADDRESS Linnégatan 6, SE-114 47 Stockholm, SWEDEN
E-MAIL info@rpm.se WEB www.rpm.se ; www.rpmfonder.se