by JUHI KAPOOR

NOT A SOUL TO SCUPPER THE PLAN

Quantitative investing uses mathematical or statistical models to make investment decisions. Should you go for it?

Some of you might find it surreal that your money is being managed by a computer software and not by a fund manager. But quantitative investing, or quant investing, does just that and is now being offered in India, under all major platforms, including exchange-traded funds (ETF), mutual funds (MF), portfolio management services (PMS) and alternative investment funds (AIF).

What's a quant product? It is one that has a computer software automatically picking stocks for investors from the bourses. There are high-frequency models, which employ short holding periods ranging from a few minutes to a day, or factor-based models which try to quantify the fundamental style. The factor-based model utilises a combination of financial, economic or market-related factors. The simplest way to explain this is, for example, an algorithm built to pick 10 stocks with least price-earnings (PE) ratios from S&P BSE 100.

The quant model does not require large research teams and this makes it more scalable. Says Paul Parampreet, head of equities, Edelweiss Asset Management: "Quant models are very efficient and cost-effective in their ability to asses a large universe of stocks and deliver on multiple mandates." The fund manager's role to pick stocks is nominal, thus, eliminating human bias. While evaluating, thorough back-testing of a model across various market conditions is carried out to ensure its robustness across volatility phases. Individual managers should not count while evaluation, but the model developer and his understanding of investing counts a lot.

TEETHING TROUBLES

The performance of equities in the past five years has been dull and this causes aversion among investors and equity markets and, therefore, to quant products. The quant strategy may or may not work out well in a volatile scenario as it lacks human intelligence. Since the assumptions are tracing certain historical trends, if the stock fails to replicate the historical patterns, the strategy may fail to generate alpha, returns over and above that of the broad market. Another challenge is the regulatory environment, although the Securities and Exchange Borad of India (Sebi) has introduced the AIF structure to facilitate investors. Says Aditya Gadge, CEO, Association of International Wealth Management of India: "Sebi gives protection through the minimum ticket size of ₹1 crore for participation in AIF products." For the regular retail investors there are mutual fund and ETF platforms. In the US, documented net worth of above $1 million can be targeted by hedge fund managers. Says Kalpesh Kinariwala, CEO, Capveda: "The regulatory environment is not conducive from an investor's perspective, especially because of the lack of clarity on the taxation front."

Furthermore, the quant style is new and fund managers are learning as they go. Says Radhika Gupta, founding principal of Forefront Capital Management: "Most wealth managers outsource quant products rather than manufacturing them internally

WHY GOOD

- Eliminates fund manager's bias
- Cost efficient
- Protects the downside

WHY NOT

- Lacks human intelligence
- Traces historical patterns
- Difficulty to identify shift in market conditions

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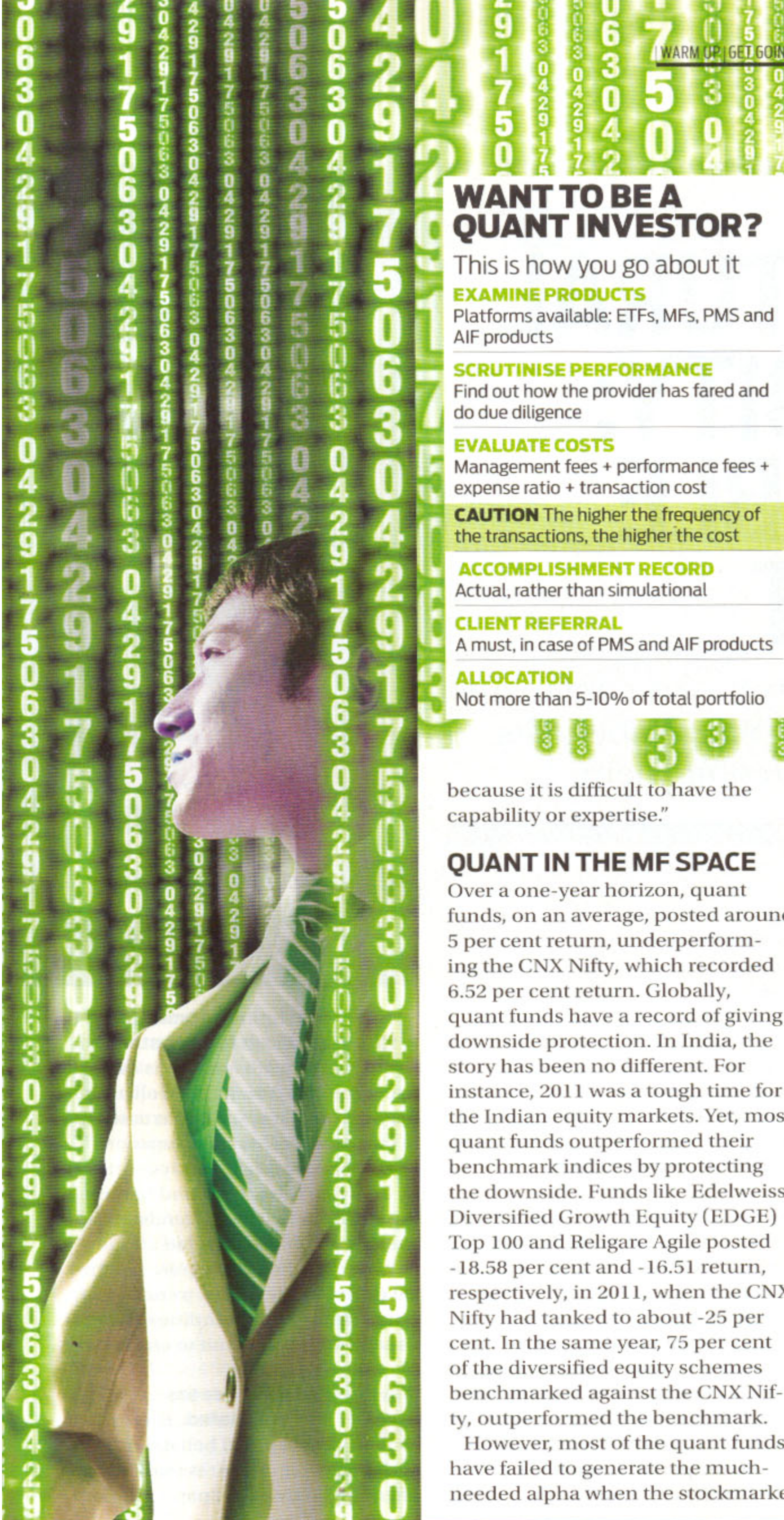

WANT TO BE A QUANT INVESTOR?

This is how you go about it

EXAMINE PRODUCTS
Platforms available: ETFs, MFs, PMS and AIF products

SCRUTINISE PERFORMANCE
Find out how the provider has fared and do due diligence

EVALUATE COSTS
Management fees + performance fees + expense ratio + transaction cost

CAUTION The higher the frequency of the transactions, the higher the cost

ACCOMPLISHMENT RECORD
Actual, rather than simulational

CLIENT REFERRAL
A must, in case of PMS and AIF products

ALLOCATION
Not more than 5-10% of total portfolio

Graphics: VARUN VASHISHTHA

because it is difficult to have the capability or expertise."

QUANT IN THE MF SPACE

Over a one-year horizon, quant funds, on an average, posted around 5 per cent return, underperforming the CNX Nifty, which recorded 6.52 per cent return. Globally, quant funds have a record of giving downside protection. In India, the story has been no different. For instance, 2011 was a tough time for the Indian equity markets. Yet, most quant funds outperformed their benchmark indices by protecting the downside. Funds like Edelweiss Diversified Growth Equity (EDGE) Top 100 and Religare Agile posted -18.58 per cent and -16.51 return, respectively, in 2011, when the CNX Nifty had tanked to about -25 per cent. In the same year, 75 per cent of the diversified equity schemes benchmarked against the CNX Nifty, outperformed the benchmark.

However, most of the quant funds have failed to generate the much-needed alpha when the stockmarket is rising. For instance, in 2012, when the Nifty returned 27.7 per cent, Religare Agile Fund posted a mere 21.41 per cent—lagging its benchmark by a margin. Though EDGE Top 100 managed to give 29.77 per cent return in 2012, it just marginally beat the Nifty. Returns from quant funds vary widely. Therefore, investors should look at the funds' past record before investing.

DIVERSIFICATION GAINS

Quant investing offers diversification benefits because of low correlation between the different investment styles. Says Sunil Singhania, head, equities, Reliance Capital Asset Management: "Quant funds provide an additional asset diversification option to the investors."

Yet, they cannot substitute for the fundamental style because even though the quant products eliminate human error, they may fail to adapt to the market conditions quickly, as compared to other regular equity-oriented schemes. Says Ramanathan K., executive director and chief investment officer, ING Investment Management:"Quantitative investing is not a substitute for the traditional style of investing. It complements well." Wealth managers could allocate a portion of both the actively-managed money and index-based passively-managed money of the client to quant investing. Says Vikas V. Gupta, executive vice-president, Traded Markets & Investment Research: "Globally, wealth managers put 30-50 per cent in passive conventional index, 20-50 per cent in active and 5-20 per cent in quant models." Investors with high-risk appetite and those who do not want to bet on a fund manager's skills in stock picking can consider quant investing allocating 5-10 per cent of their total equity investments and hold for a year or so.

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