Employing Trend-Capture in Pursuit of Better Risk-Adjusted Returns

Integrating Trend-Capture into an investment process is a simple, systematic and transparent way to add value consistently over time

For professional investors only

It's simple: you want to capture a large part of bull trends and avoid most of the bear trends over different market cycles

Recent Studies show that over 80% of active managers in most regions have underperformed their benchmark over long-term time horizons[1]. The rejection of innovative ideas and methodologies, often due to the fear of change, has played a part in eroding value and diminishing investor trust.

It is well known that our industry is under a period of rapid change. Developing a plan designed to withstand industry challenges, market conditions as well as regulatory change is essential for sustained growth.

And, with a market consensus expectation of more uncertainty ahead, even the small number of managers that have outperformed their benchmarks are adding an extra layer of intelligence to ensure their performance is sustained and delivered for clients consistently over time.

[1] SPIVA Statistics, December 2018

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WHY CONSIDER TREND-CAPTURE?

In order to understand the reasons that could lead to price trends in a stock, we focus first on the phenomenon of **performance dispersion** across a group or index of securities. Dispersion is the difference between the best and worst performers within a particular group of securities. The greater the dispersion, the higher the potential to gain meaningful returns above the average return of the index. Our research and testing, which covers over 20 years of data across multiple investment universes, shows that markets can exhibit recurrent dispersion in all types of conditions. In periods of high dispersion, active managers have more opportunities to generate excess returns through positive stock selection.

While this makes a compelling case in support of active management; in order to really benefit from dispersion it is important to be able to consistently identify most of the winners and avoid a significant part of the losers. And, with price trends having the potential to remain detatched to underlying fundamentals for significant periods, integrating trend-capture within an investment process is more important today than ever before.

There are many explanations as to why price trends can exist in a stock, industry or even an index:

1. Irrationality of market participants
2. Lead lags in information dissemination
3. Herding behavior
4. Market friction & information uncertainty

These are some of the main reasons that also explain why the majority of outperformance & underperformance in any investment universe is concentrated in a narrow range of securities, typically 20% to 30% of the universe. It is these securities that will generally be the ones that are demonstrating strong price trends, both uptrends and downtrends.

As such, we believe that capturing a large part of bull trends and avoiding most of the bear trends in individual stocks, ETFs and sectors over different market cycles is the essence of successful investing.

HOW DOES IT WORK?

Trendrating's unique and innovative approach to integrating trend-capture into an investment strategy has been formed following twenty years of experience in financial modeling and software development coupled with a dedicated four year research & development program.

Our model offers a unique rating of trends where **A** and **B** indicate a bull trend and **C** and **D** mark bear moves. This rating is known as the Trend Capture Rating. Through use of advanced analytics and technology to help analyse large volumes of data, the model is designed to self-adjust to market conditions and use adaptive time windows to spot trends sooner compared to traditional static models. We call this approach Smart Momentum™.

This ranking is, however, just the starting point. For example, the model enables investors to perform a more detailed analysis between a set of highly rated securities - by assessing the quality and magnitude of a trend. This means that investors can gain a more informed view of a security during the investment due diligence process.

Furthermore, having the tools to detect trends that are likely to change direction- known as Retracement - means that investors are better equipped to run the most optimal security mix for the prevailing environment.

Using all of these features in combination can help create timely rebalancing opportunities which lead to investors generating better performance while carefully managing risks. We know this because every decision made using the model can be **measured, tracked and reported on over time.**

"Forward-thinkers will profit from new tools that incorporate advanced analytics, models & technology. The rest will be held hostage by skepticism and inertia"

–Rocco Pellegrinelli, Founder & CEO

ADDRESSING THE CHALLENGES OF TRADITIONAL METHODS

Trendrating has designed this process from the ground up to address a number of the structural problems in traditional methods. Our approach fills a criticial gap in market intelligence within a **well-defined, transparent and risk controlled framework**

① EFFECTIVE TIMING

Late entry can result in reduced participation in bull trends. Conversely, late exit can cause substantial downside capture

② MANAGING COSTS

High levels of turnover due to market noise and conflicting signals can have the impact of higher trading costs and ultimately capital erosion

③ CONTROLLING RISKS

A simplistic approach to trend-capture modeling can create a high concentration of risk and be prone to sharp drawdowns

The Trendrating "Smart Momemtum™" Approach

Captures trends at an early stage as well as quickly identifying trend reversals to create optimal portfolio rebalancing opportunities

Filters out price action noise such as high volatility and false breakouts to assess the true underlying trend structure for long-term investors

Utilises a blend of different indicators and analytical tools to pick up changes in trends while measuring the magnitude and quality of the trend

THE RESULTS

To illustrate the benefits that trend-capture can bring to an investment process, we present two example strategies based on Developed Europe and US equity universes. These **hypothetical strategies are rules-based** and rebalanced on a weekly basis. The objective is to outperform the benchmark by **using Trendrating's tend-capture analytics** to include stocks that have a greater potential to outperform – typically **A** and **B** rated securities- and by excluding those that have a greater potential to underperform – typically **C** & **D** rated securities.

The ranking between the ratings are based on Trendrating's Smart Momentum™ score as outlined within the *How Does It Work* section. Portfolio construction is based on a set of trade thresholds and pre-defined rebalancing rules to retain consistency and avoid excessive turnover.

It is important to recognise that whilst these examples are based on a pure rules-based approach, the Trendrating model is flexible and designed to seamlessly integrate alongside any existing investment research and portfolio management process.

Trendrating Developed Europe (Net) Vs Benchmark Index (2006 - 2019)

Trendrating Europe Strategy — Benchmark Index
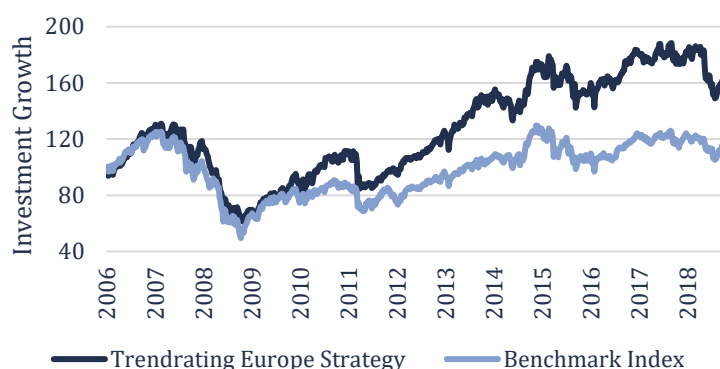
Trendrating US (Net) Vs Benchmark Index (2006 - 2019)

Trendrating US Strategy — Benchmark Index
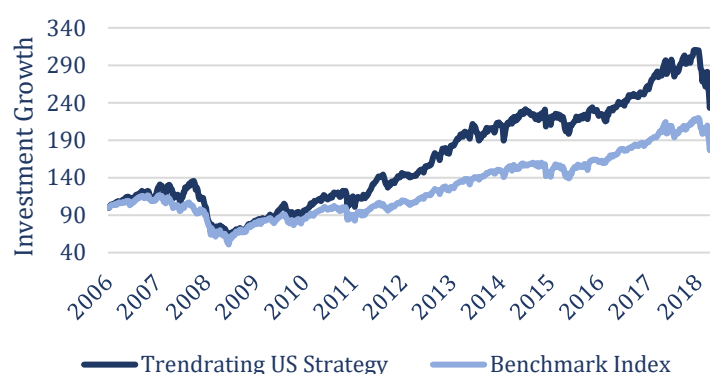
Example 1: Back-tested Results of **Trendrating Developed Europe Strategy** (2006-2019) in EUR

	Annual Return (%)	Annual Volatility (%)	Information Ratio	Beta	Max Drawdown (%)
Trendrating Developed Europe (net)	4.10	19.14	0.21	0.88	-53.57
Developed Europe Index	1.44	19.07	0.08	-	-60.48

Example 2: Back-tested Results of **Trendrating US Strategy** (2006 -2019) in USD

	Annual Return (%)	Annual Volatility (%)	Information Ratio	Beta	Max Drawdown (%)
Trendrating US (net)	8.91	20.37	0.43	0.96	-56.56
US Equity Index	6.30	18.69	0.33	-	-56.43

HOW CAN YOU BENEFIT?

	Idea Generation	Idea Validation	Risk Control	Portfolio Analysis	Governance & Oversight
Wealth Managers - Managed Accounts	Screen for ideas across single securities, countries, sectors & markets in order to select potential winners. Look for confirmation at trend level via an A/B rating	Validate existing ideas based on Smart Momentum™ and Retracement in order to establish a clear ranking within a particular group of securities and execute a sanity check	Consider Sell when downgraded to C/D	Utilise the Trend Capture Model to run health checks on portfolio at the aggregate level	Document decision making by exporting all ratings data to your existing spreadsheets. Build custom reports to communicate investment information
Wealth Managers - Advisory Accounts	Build a white list comprising of highly rated securities which have the greatest potential to generate positive returns	Validate existing ideas based on Smart Momentum™ and Retracement in order to establish a clear ranking within a particular group of securities and execute a sanity check	Suggest a security switch. Exit C/D rated securities to buy A rated securities. Use Retracement analytic to identify when a trend is emerging or coming to an end.	Evaluate the impact of recommendations on the weighted Trend Capture Rating™ of a portfolio	Ensure white list is suitable for the prevailing environment. Stay on top of trend capture changes in your basket of securities. Build custom reports to communicate investment information
Fund Management Long-Only, Long/Short & Multi-Asset	Screen from your relevant investment universe and consider securities with high ratings as long candidates (or securities with low rankings as short candidates). Establish clearly defined parameters based on universe, market or sector	Complement fundamental research by validating ideas based on Smart Momentum™ and Retracement. Use granular rating levels to guide tactical allocation decisions - i.e to overweight securities that are in synchrony with price trends	Keep the portfolio percentage exposure to C/D rated stocks low. Use Retracement to reduce exposure or keep an eye on trends that are emerging or coming to an end	Monitor portfolio positions and rank existing positions to help guide buy/sell decisions whist respecting portfolio constraints and strategy parameters	Be automatically alerted to trend capture changes in your portfolio. Leverage library of charts, data tables and graphs to document information and communicate to a wide range of audiences
Sell Side	Evaluate trends across single securities, countries, sectors & markets in order to provide macro and security level ideas.	Complement existing research by validating ideas based on Smart Momentum™ and Retracement	Alert your client of trend downgrades and propose alternative ideas	Utilise the Trend Capture Model to run health checks on portfolio at the aggregate level	Leverage library of charts, data tables and graphs to document information and communicate to a wide range of audiences

✓ **Complements Fundamental Processes**

✓ **Provides Access to Advanced Technology**

✓ **Forward-Looking & Dynamic**

✓ **Better Risk-Adjusted Returns**

✓ **Fully Measurable & Trackable**

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