Avoid macro "landmines"– a case study for stock pickers

August 30th 2022

Summary

- A recent Goldman Sachs study revealed GVIP – the ten most popular stock picks by HF managers – was the worst performing strategy year to date.

- It is not that managers have suddenly lost the ability to pick winners. It is because macro "landmines" are ruining performance.

- How is an equity manager busy analysing bottom-up company fundamentals supposed to insulate themselves from the huge array of macro crosswinds that plague financial markets currently?

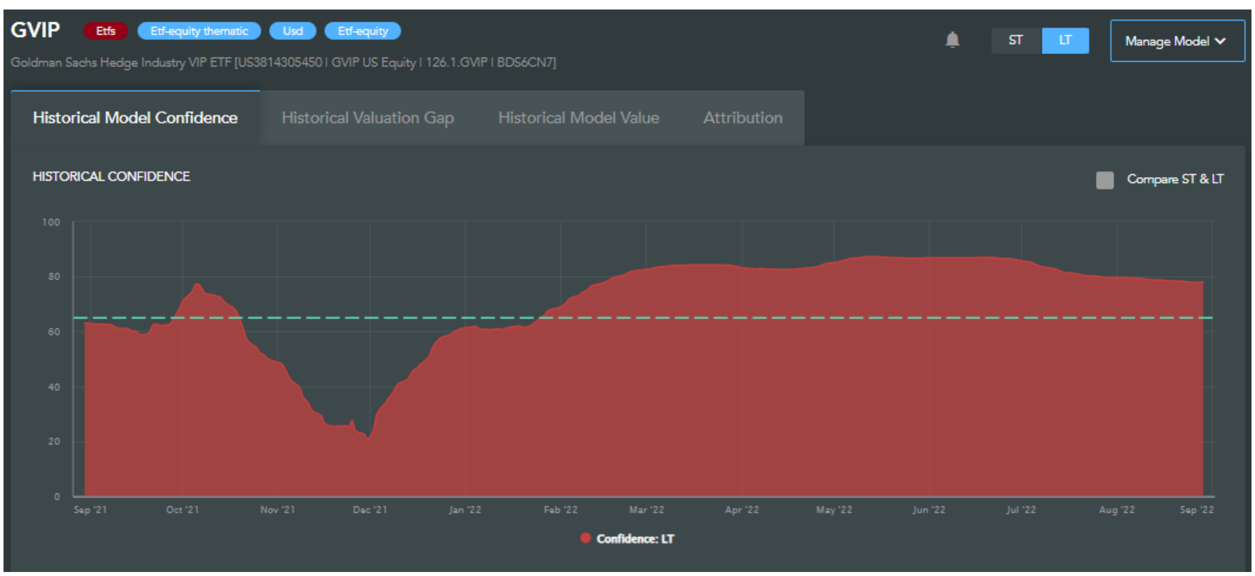
Section 1: Background

GVIP is an ETF that tracks Goldman's Hedge Fund VIP index. It captures HF managers' "very important positions" – basically their top 10 favourite longs.

It has attracted a lot of attention recently due to its poor performance. In 2022 it has underperformed all the major US equity indices & other fund strategies including equity hedge fund indices, trend following & macro approaches.

Hedge fund managers haven't suddenly **lost the ability to pick winners**. It's more that their bottom-up analysis of company fundamentals has been **blown up my macro shocks**.

That is borne out by the fact that Qi's model for GVIP is in a strong macro regime. Model confidence is 78% currently & has been above 70% since the end of January.

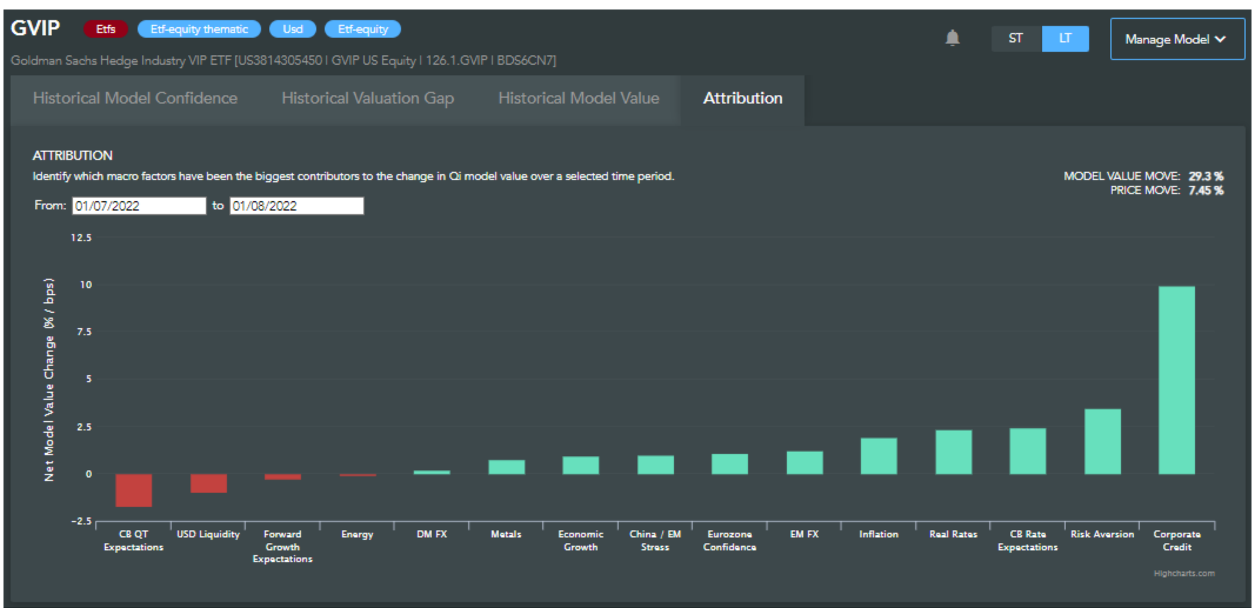


Section 2: How can Qi help?

The chart shows GVIP spot price (white) & macro-warranted model value (red). It shows how macro conditions for GVIP deteriorated over much of H1 2022, improved over July / early August, but have subsequently turned lower once again.

The next chart employs Qi attribution analysis which enables users to identify which factors are responsible for certain moves.

So, for example, focusing on this summer's rally, GVIP model value rose 29% over the month of July. The biggest single driver by far was corporate credit spreads. It alone accounted for nearly a 10% improvement in macro conditions last month.



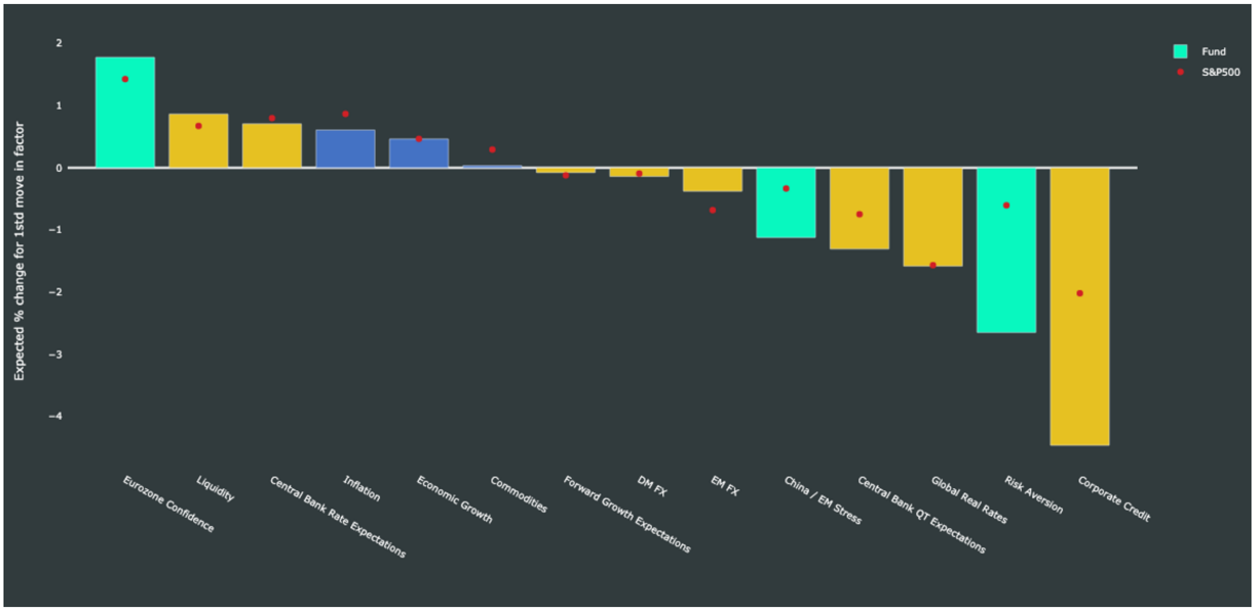
In fact, the overall picture that emerges is one where easier financial conditions that foster a “risk on” vibe is the macro environment HF managers need for their stock picks to perform.

So, what happens if the opposite scenario pans out? Qi Macro Risk Reports can help investors screen for tail risks.

Section 3: Identify macro exposures

The chart below shows a Qi Macro Risk Report for GVIP but can be run for any client portfolio / strategy. Either via Qi API or via Goldman Sachs Marquee.

The chart shows the funds macro exposure outright & relative to a chosen benchmark. It captures the percentage move in fund performance for a one standard move up in each macro factor.



Once again, it shows GVIPs significant sensitivity to tight credit spreads – both in outright terms, & how it is twice as reliant on credit than the S&P500.

Similarly, note strong negative sensitivity to measures of risk aversion. Spikes in VIX would hurt GVIP significantly more than the broader equity market.

The next step is scenario analysis.

Section 4: Scenario analysis

Because Qi captures the independent relationship between individual macro factors & the portfolio, each factor sensitivity can be used as a building block.

Users can then stress test different scenarios. These could be single factor shifts. Such is the importance of credit that a 2 standard deviation shift in credit alone (macro conditions otherwise remains constant) results in an 8.9% hit to portfolio performance.

In reality, credit spreads would be widening in a broader 'risk off' environment. Users can factor in higher levels of VIX & increased sovereign stress to assess the overall impact.

Arguably a key question for late 2022 & into 2023 is at what point does stagflation shift into outright recession? Qi allows you to stress test both scenarios. What's the impact on your fund of weaker growth but sticky inflation, versus the sensitivity to falling growth *and* falling inflation.

Section 5: Conclusion

- The first step to navigating the current macro-driven market environment is to identify your macro exposures.
- Then Qi can drill down to reveal the individual holdings responsible for those exposures.
- If they are core holdings & divestment is not an option, Qi can work with you to help calibrate weightings to retain the position but reduce your macro risks.
- All this can be done in short order with Qi's help. Freeing up time to let you concentrate on your core bottom-up strategy.