ADORA EQ – 2022/23 in Review – Navigating the Financial Metamorphosis

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With the new year ahead, we take the opportunity to look back at a magnitude of significant events that have shaped the financial markets over the last two years. A financial Metamorphosis[1] that has turned sound economic forces upside down and required more than once an agile risk management system to navigate the financial markets. Moreover, the last two years have shown that an association of one specific event happening, leading to a respective outcome is too simplistic. In fact, the causality of the financial markets is multidimensional and investors far from rational. The potential truth in the outcome thus lies in utilizing various sources of information, models and considering the behavioural nature of the investor. Figure 1 serves as our witness for the Metamorphosis over the last two years, showing how our equity risk overlay – ADORA[2] – have been used to navigate the developments of the MSCI ACW Net Total Return EUR Index.

The Metamorphosis starts at the beginning of 2022. Driven by geopolitical tensions, due to Russia's invasion in Ukraine, and ongoing turbulence from the Covid pandemic, with Chinas zero-COVID policy leading to the closure of Shanghai harbour. As the year would later show these events had a long-lasting impact on lagging macroeconomic variables. Back then the investor's reaction was with the first low of 2022 occurring on March 14th. Our ADORA model was able to successfully adapt to these changes, with the behavioural component bringing the investment exposure down to 25%.

The unfolding shortage of goods and the subliminal energy crisis resulted in a cost-of-living crisis that rippled through economies worldwide. Macroeconomic variables, like inflation rose to values last seen in the 1980s[3] in OECD countries. Central Banks intervened heavily in the second and third quarter of 2022, bringing up the fear of recession. Utilizing a variety of different data sources including price, macroeconomic, fundamental and sentiment data, our ADORA model was able to dynamically react to these developments that now also expressed themselves in key macroeconomic variables. Subsequently investment in equity was completely dissolved, avoiding an equity market drawdown of 16.30% (in comparison the strategy stood only at a 5.79% drawdown).

The remainder of the year was characterized by negative returns in both equity and fixed income securities, leading to a structural break that eliminated the diversifying nature of these two asset classes. The ADORA model navigated this period in an agile fashion, with the behavioural component showing an average market exposure of 50% throughout the third quarter, while the machine learning (ML) component aimed at capitalizing on the rebound that started in October 2022. The resulting investment

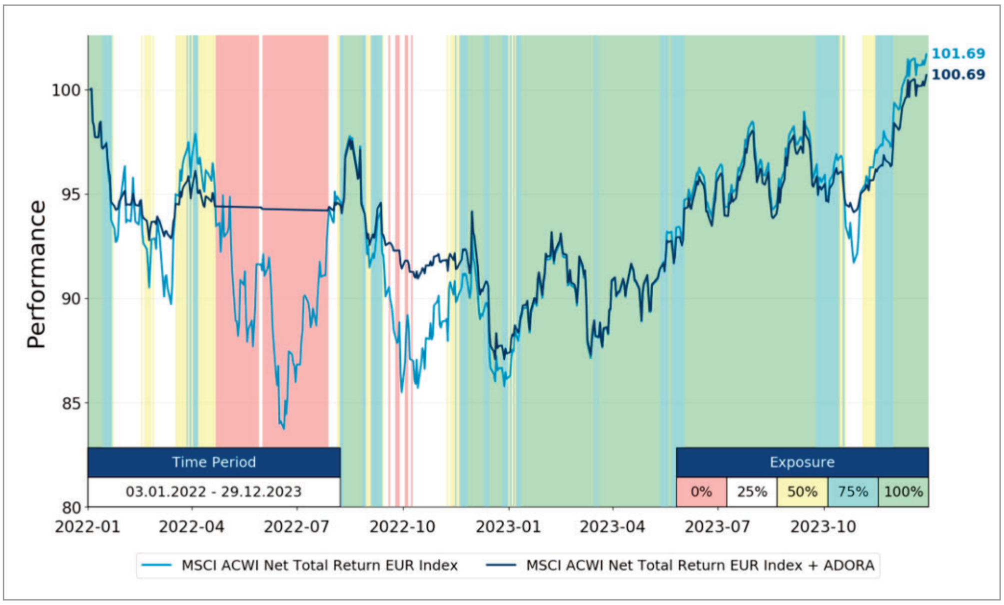
1) Metamorphosis: derived from ancient Greek meaning "transformation" or "transforming".
2) ADORA short for: Advanced Data Operating Risk Agent
3) International Monetary Funnd via WorldBank
https://data.worldbank.org/indicator/FP.CPI.TOTL.ZG?locations=OE, accessed 02.01.2024.

exposure moved between a complete hedge in late September/early October up to a 25% and 50% investment during the market recovery periods, even reaching 100% towards the end of the year.

Fast forwarding to 2023. The beginning of the year marked a trend reversal and the culmination of the Metamorphosis. Central banks around the world continued to raise interest rates being faced with high inflation. Sound economic theory would foster a grim outlook for the start of the last year with equity markets slowing. However, what followed was an equity market rally that hit its peak at the end of 2023, with a +18.06%[4] increase in value, leaving behind puzzled financial experts that had it all not seen coming.

While 2023 allowed equity indices reaching levels never seen before, the year exhibited a strong sideways market in the third quarter and a significant sell off with a sharp recovery in the fourth quarter. Two periods that are prone for risk management solutions to produce false signals and enter/exit the market at unfavourable times. Our ADORA model stayed put throughout the sideways market, indicating that downward trends were not substantial enough to render a hedge. It was only until the fourth quarter when investment exposures were reduced substantially by both components (ML and momentum) due to an interest rate hike induced equity market sell off. At the same time the dynamic nature of the ML component allowed to re-enter the market quickly and to participate at the year-end rallye.

FIGURE 1
Simulated performance of Advanced Data Operation Risk Agent (ADORA)



	Return	Return p.a.	Volatility p.a.	Max Drawdown
MSCI ACWI Net Total Return EUR Index	1.7%	0.8%	14.3%	-16.3%
MSCI ACWI Net Total Return EUR Index + ADORA	0.7%	0.3%	8.9%	-13.0%

Source: La Française Systematic Asset Management GmbH, Bloomberg, Own calculations; Simulated back calculation: 01/2022-12/2023. For illustration purposes only. Past and simulated performance is not a reliable indicator of future performance.

Over the two-year period the usage of the ADORA model led to an approx. 40% reduction in the volatility and shielded the investor from a 16.3% drawdown resulting from the buy-and-hold strategy.

As of January 2024, the world is still out of balance, with the devastating events happening in the middle east, the still ongoing Russian-Ukrainian conflict and equity valuations at levels never seen before. Still, we embrace the future with ease, knowing about the agility of our risk management solutions and its possibility to adapt to the ever-transforming nature of the financial markets.

4) Return based on MSCI All Country World Net Total Return EUR Index. Time period: 30.12.2022 – 29.12.2023

Main risks:

Risk of capital loss: The investor is notified that his capital is not guaranteed and therefore might eventually not be returned.

Model risk: The model may not always behave as expected. Therefore, the model cannot guarantee to reduce losses in value.

Risk associated with derivatives: The model uses derivatives. These are financial instruments whose value depends on the underlying asset. Minor fluctuations in the price of the underlying can lead to significant changes in the price of the derivative.

Do you have any further questions? – We are pleased to help you.

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