LA FRANÇAISE

Crédit Mutuel Alliance Fédérale

UNDER THE MICROSCOPE – EQUITY, FOREIGN EXCHANGE AND FIXED INCOME MARKETS IN 2024

by Dr. Denisa Čumova, FRM & Dr. Philipp J. Kremer, CFA, CAIA, La Française Systematic Asset Management

The first half of the year 2024 let investors indulge themselves in a global low volatility environment, across equity, FX and fixed income markets. While such a period proved useful for equity investors, who suffered through the seminal changes in macroeconomic forces that characterized the years 2022 and 2023, it proved difficult for FX and Fixed Income investors.[1] The former were exposed to a difficult range market making it hard for risk management to extract the underlying direction of the market. For Fixed Income investors the constant balance between “fear of a recession” and “soft-landing” culminated in opaque interest rate changes on the horizon and subsequently to a volatile market development. Looking at each asset class in turn, we highlight how our Advanced Data Operating Risk Agent (ADORA) navigated each’s specially.

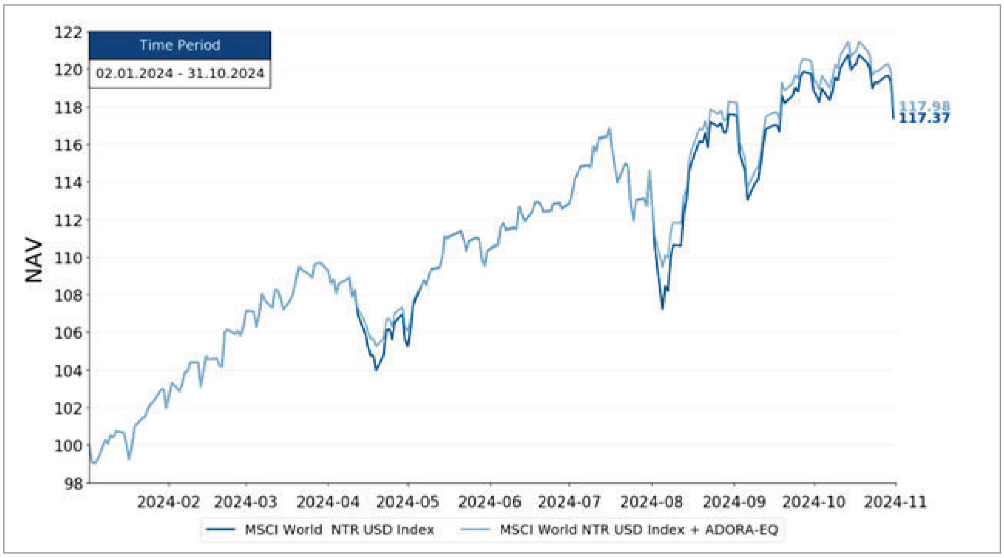
1) For readers, which are interested in the macro economical shifts that took place in the years 2022 and 2023 are referred to ADORA EQ in Review – Navigating the Financial Metamorphosis

The Equity Market

In the first half of 2024, equity markets rose by nearly 16%.[2] When summer came and the earnings season was over, interest shifted from microeconomic factors to macroeconomic variables. With the US reporting in late August weaker than expected employment data, concerns erupted that the FED was too late with lowering interest rates and still obtaining a soft landing. At the same time the Bank of Japan started to raise interest rates leading to the unwinding of carry trades and a more than 19% drop in the Nikkei.[3] With these developments volatility was officially back on the markets.

Figure 1 shows the year-to-date performance of the ADORA – EQ model considering an investment in the MSCI World Net Total Return USD Index. Our ADORA-EQ Model was able to participate on the rising market developments during the low volatility phase, while successfully navigating volatile periods like the unfolding of the carry trade. By increasing the hedge ratio promptly to 50% and unwind it swiftly in the sharp market reversal the ADORA strategy reports a nearly 2% lower Drawdown, as compared to the Index.

FIGURE 1
Performance of the ADORA-EQ strategy



	Return	Return p.a.	Volatility p.a.	Sharpe Ratio	Max Drawdown
MSCI World NTR USD Index	17.4%	21.3%	10.9%	1.60	-8.2%
MSCI World NTR USD Index + ADORA-EQ	18.0%	22.1%	9.8%	1.84	-6.3%

Source:
La Francaise Systematic Asset Management GmbH; Bloomberg; Own calculation based on MSCI World NTR USD Index; Simulated back calculation: 01/2024-10/2024. For illustration purposes only. Past and simulated performance is not a reliable indicator of future performance.

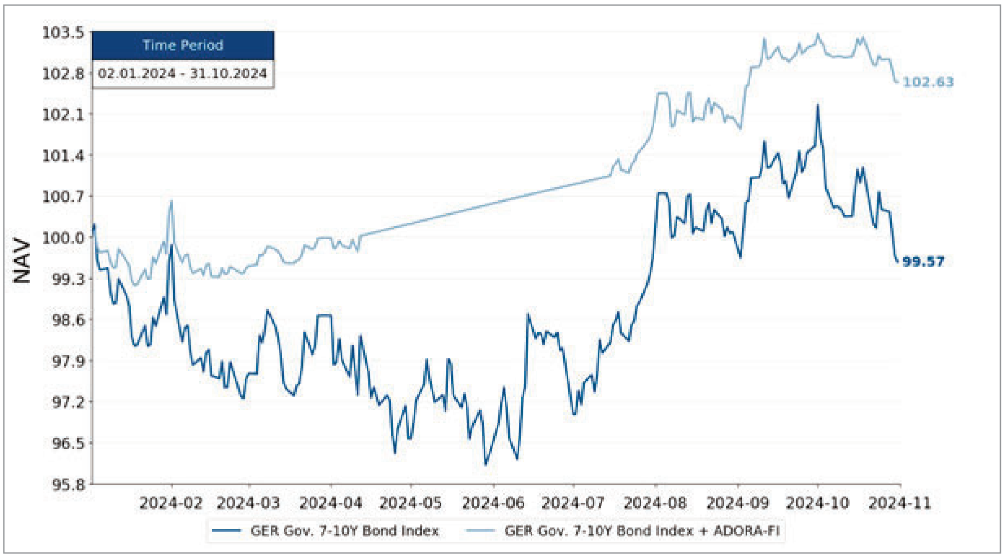
2) Source: Bloomberg | Equity Market: MSCI World NTR USD Index; Period: 29.12.2023-16.07.2024 | Fixed Income: | Foreign Exchange: EUR/USD exchange rate
3) Source: Bloomberg, Nikkei 225 Index, Period: 31.07.2024 – 05.08.2024

The Fixed Income Market

In the environment of very sensitive bond rate reactions to the changes in monetary policy, our active duration management added year-to-date a significant value, when compared to passive bond investments. Although the end of the interest rate hikes and the beginning of the global interest rate lowering cycle – starting with the ECB, who cut rates by 25 bps in June and by the FED that cut interest rates by 50 bps in September - was taken for granted, the speed and the magnitude of the rate cuts kept uncertainty high and resulted in trend swings in mid- and long-term bond rates.

The ADORA-FI model applied on an investment in the 7-10Y German Government Bond Index reduced the drawdown by 70%, while reporting an excess return of 3%, as compared to the Buy and Hold strategy (Figure 2). As evident, the system's flexibility allowed to navigate even such specific market patterns successfully. Being hedged through the difficult summer month, the ADORA system was able to pick up on the strong rebound from end of July and protect these gains during the most recent period of losses.

FIGURE 2
Performance of ADORA-FI strategy



	Return	Return p.a.	Volatility p.a.	Sharpe Ratio	Max Drawdown
GER Gov. 7-10Y Bond Index	-0.4%	-0.5%	6.0%	-	-4.1%
GER Gov. 7-10Y Bond Index + ADORA-FI	2.6%	3.2%	2.4%	-	-1.3%

Source:
La Francaise Systematic Asset Management GmbH; Bloomberg; Own calculation based on German Government 7-10Y Bond Index; Simulated back calculation: 01/2024-10/2024. For illustration purposes only. Past and simulated performance is not a reliable indicator of future performance.

The FX Market

With the ECB starting the global interest rate lowering cycle in June and the FED joining it shortly after, EUR-based investor holding foreign investments were waiting in vain for a USD appreciation on the backdrop of double-digit gains in the past years. As such an average hedge ratio of 68% for most of the time represented the correct action of our ADORA FX system for a EUR investor that holds USD denominated assets. As evident from Figure 2, the system was able to navigate difficult sideways market well, without high costs related to trend switches, which are typical for pure trend following models.

FIGURE 3
Performance of ADORA-FX strategy

	Return	Return p.a.	Volatility p.a.	Sharpe Ratio	Max Drawdown
USD long vs. EUR	0.5%	0.6%	5.2%	0.12	-5.1%
USD long vs. EUR + ADORA FX	-2.3%	-2.8%	2.0%	-	-2.8%
Static Hedge	-1.3%	-1.6%	0.0%	-	-1.3%

Source:
La Francaise Systematic Asset Management GmbH; Bloomberg; Own calculation based on EUR/USD Exchange Rate; Simulated back calculation: 01/2024-10/2024. For illustration purposes only. Past and simulated performance is not a reliable indicator of future performance.

The ADORA System

The developments above show that a globally diversified investor requires a risk management system that strikes the right balance between a minimal intervention in good times, but a dynamic reaction in time when market volatility rises. At the same time such systems should be able to account for the different market patterns of the respective asset class. The ADORA model has proven itself useful, regardless of the asset class considered. Furthermore, the system allows the investor to choose whether it should be applied to equities, fixed income or FX altogether, or just to one of them. With it the investor is well posed to embrace prolonged periods of low or (suddenly) high volatility, whether they have just returned or are here to stay. [4]

4) We refer the interested reader for further information and additional papers on our ADORA system to: Risikomanagement - La Française Group (la-francaise-systematic-am.com)

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

DR. DENISA ČUMOVA, FRM

Head of
Portfolio Management &
Quantitative Research

DR. PHILIPP J. KREMER, CFA, CAIA

Senior Portfolio Manager &
Quant Researcher

MAXIMILIAN MUDRA

Director Sales
Institutional Business Development

P: +49 (0) 69 29 72 43 -802
M: +49 (0) 152 28 57 24 57
maximilian.mudra@la-francaise.com

LA FRANÇAISE
Crédit Mutuel Alliance Fédérale

La Française Systematic Asset Management GmbH
Neue Mainzer Str. 80, 60311 Frankfurt am Main, www.la-francaise-systematic-am.com

Status: 11-2024