JUNE 2019

ALLIANCEBERNSTEIN

Q&A

NOT ALL LOW-VOLATILITY STRATEGIES ARE CREATED EQUAL

Trade tensions, geopolitics and the late stage of the economic cycle: investors have plenty of reasons to seek a safe haven from volatility. Opinions on the best way to build such a haven vary widely, however. **Kent Hargis** and **Sammy Suzuki**, **AllianceBernstein's Co-Chief Investment Officers of Strategic Core Equities**, discuss why the combination of fundamental and quantitative research is the most powerful way to give investors shelter without sacrificing performance.

Why should investors be thinking about low-volatility strategies right now?

Sammy Suzuki: It's no secret that we're late in the cycle, and a downturn will come at some point. A strategy that provides downside protection while also beating the market over time is a powerful incentive to stay invested when that moment arrives. We aim to capture 90% of returns when markets are going up and only 70% of the downside when they're falling.

Some would say that the simplest way to build a low-volatility portfolio is to invest in lower-beta stocks. Is it the best way?

SS: A purely quantitative approach that invests in lower-beta stocks is also quite sensitive to interest rates. When rates are at risk of rising, as they have been over the last couple of years, low-beta strategies can nose-dive when they're supposed to be protecting investors. That was true in both February 2018 and autumn 2016.

We avoid that risk by using both quantitative and fundamental research to find stable, high-quality companies with attractive valuations and business models that deliver consistent revenues.

Besides avoiding overexposure to rising rates, what are the advantages of an approach that combines quantitative and fundamental research?

Kent Hargis: Both approaches are strong individually, but the strengths of each one offset the limitations of the other. Quant is great when you have a lot of information and a long history—and when that history is likely to be repeated. It's not very good when you're seeing a situation for the first time. Fundamental research allows you to dive deeper into a company or industry, but it's harder to scale. Using only one method would be like tying one hand behind your back.

SS: Exactly. Quantitative research is less prone to emotional swings and predictable biases in human judgment. But a quant-only strategy relies on the future resembling the past. Fundamental analysts have a lot of information that aims to predict which companies will be stable and profitable in the long term; it just doesn't always fit nicely into a spreadsheet.

The other issue with quant-only strategies is that historical data sets can be skewed. US interest rates have been falling for 30 years, for example. If you're basing your decisions exclusively on data from that period, you're missing critical information about how markets and individual stocks act in rising-rate environments.

Can you give some examples of how fundamental research helps round out your stockpicking in today's market environment?

SS: Quant models might say Campbell's, the soup-maker, is a really cheap, profitable company. But our fundamental research says that consumer preferences are shifting dramatically toward natural, organic products. It's been very difficult for Campbell's to shift gears.

KH: Disruption is a tough thing for quant models to grapple with, too. They focus on history, but there's no real precedent for Amazon's disruption of the media and retail industries.

It seems like combining quantitative and fundamental research would be helpful for many investment strategies. Why is it helpful for a low-volatility portfolio in particular?

KH: It's a common notion that quant strategies are better at managing risk because they provide a point of view when market sentiment shifts suddenly or when emotions take over during stressful periods. Many people think of qualitative research as more suited to generating outsize returns. That's why low-volatility strategies tend to be more quantitative in nature, and those that attempt to beat the market are usually fundamental. But we're trying to both provide downside protection and beat the market.

Are current valuations making it harder to find high-quality, stable companies at an attractive price?

KH: Yes, high-quality companies can get crowded, which in turn can create valuation risk. We thought that was especially true in September 2018, after a multiyear rally in quality and growth.

How are you getting around that problem?

SS: For one thing, we're willing to pay a little bit more than we would have in the past for high-quality, stable companies.

KH: We also like to look in unexpected places, where valuations tend to be lower. In tech, for example, we don't own the highly publicized, large-cap FAANG stocks. We own companies you use every day without realizing it. If you're booking a plane ticket through Expedia, you're using a company called Amadeus that searches available flights. If you're buying something with a credit card, you're using a company called TSS that works with your bank to approve the transaction.

At a time when revered names such as IBM and GE are struggling, investors could be forgiven for being a little confused about what a high-quality company actually is. Can you explain what exactly you look for in a stock?

KH: We're looking for companies that can maintain their high returns. Maybe they have network effects that constitute a barrier to entry or proprietary data that others can't replicate. Maybe they just have a better business model than anyone else in the industry—particularly if it involves recurring, predictable revenue from subscriptions or licenses. A very strong brand is often quite helpful in the consumer space, but even the best brands deserve a close look under the hood.

Kent Hargis
Portfolio Manager
+ 24 years experience
+ 16 years with AB

Kent Hargis is Co-Chief Investment Officer of Strategic Core Equities at AllianceBernstein (AB). Previously, he was the firm's Head of Quantitative Research for Equities. Before joining AB in October 2003, Kent was a chief portfolio strategist at Goldman Sachs. Before that, he was assistant professor of international finance at the University of South Carolina.

Sammy Suzuki
Portfolio Manager
+ 26 years experience
+ 25 years with AB

Sammy Suzuki is Co-Chief Investment Officer of Strategic Core Equities at AB. Sammy, who joined AB in 1994, has managed global and emerging-market portfolios for over 13 years, and was previously a research analyst. He has a BS in finance from the University of Pennsylvania, is a CFA charterholder and a member of the Board of the CFA Society New York.