Small Managers – BIG ALPHA – Report 24

Alpha DNA's equity hedged strategies outperform Wall Street by using predictive analytics

B. G., Opalesque Geneva:

A Columbia, Maryland-based investment manager is outperforming large equity indices by identifying companies that are growing revenue and EPS faster than Wall Street analyst forecasts. To do so, they use machine learning and alternative data sources to optimise their stock selection.

"Hedged equity strategies often produce less than market returns because of the inherent cost to hedge the downside. Alpha DNA attempts to generate excess returns by investing in a concentrated portfolio of stocks that grow revenue (and EPS) faster than Wall Street analyst forecasts, and that helps offset the hedge cost and improve overall returns," says Wayne Ferbert, co-founder Alpha DNA Investment Management

Ferbert will be speaking at the **Small Managers - BIG ALPHA, Episode 5** webinar on November 30th.

Alpha-DNA's three SMAs (separately managed accounts) follow the same strategy with different cap universes. They all include a hedge using put options on an ETF that tracks either the S&P 500 in the case of the Large Cap strategy, the Russell 2000 in the case of the small and mid-cap strategy, or the HFRI Quantitative Directional Index for the All-Cap strategy.

The cumulative returns of Alpha DNA **Large Cap Hedged Equity** from inception in March 2017 to October 2021 are 125% compared to 112% for the S&P 500. It is up almost 15% YTD.

The cumulative returns of Alpha DNA **Mid Small Cap Hedged Equity** from inception in January 2018 to October 2021 are 148% compared to 57% for the Russell 2000. It is up almost 18% YTD.

The **All Cap Hedged Equity** SMA has cumulated 82% from its November 2014 inception to September 2021 against 50.4% for the HFRI Quantitative Directional Index.

The S&P 500 index is up almost 27% YTD at the time of writing while the Russell 2000 is up 20.4%. The HFRI Quantitative Directional Index is up 13% YTD as of the end of October.

Strategy

The stock portfolio (about 95% of the total portfolio) screens about 3,000 U.S. publicly traded socks, systematically assesses their near-term attractiveness leveraging alternative data and analytics, and identifies those with revenue in the upcoming quarter that are under-estimated by a consensus of Wall

Street analysts.

"We deploy supervised machine learning algorithms to uncover stocks with the potential for revenue upside in the near term and measure ourselves in terms of surprise predictive accuracy quarter after quarter," the firm says.

The hedge overlay (typically 3-5% of the total portfolio) consists of an adaptive put options strategy using broad market indices or ETFs. It maintains a 100% notional coverage relative to the market cap exposure of the portfolio.

These two components, according to Alpha-DNA, produce a resilient portfolio. The target exposure is 70% net long: the strategy is monitored daily, options are adjusted regularly, businesses are tracked continuously, equities are rebalanced monthly, and stocks are scored and ranked objectively with a quantamental basis.

One of the advantages of the strategy, according to the firm, is that it accesses equity market growth with reduced risk and benefits from the downside protection of hedges during market corrections. "This helps your clients overcome their fear of material portfolio losses with equities - and by extension, it reduces your client's temptation to time the stock market."

Alpha DNA began in 2014 as an affiliated advisor subsidiary to a larger derivatives sub-advisory firm, ZEGA Financial. It spun out of ZEGA to become an independent advisor in 2017 and launched its first hedged equity strategy that same year. The firm now has over $180m in AuM.

Wayne Ferbert is a seasoned strategy and business development executive with more than 25 years of financial services experience. The other co-founders of Alpha DNA are Arun Muthupalaniappan, a big data and analytics practitioner, and Rod Fertig, who has spent more than a decade leading customer and digital analytics transformations in large global financial services businesses.

Next webinar:

Small Managers - BIG ALPHA Episode 5
When: Tuesday, November 30th 10:30 am ET
Free registration: www.opalesque.com/webinar/

With larger quantities of capital chasing the same Alpha strategies and continuing to erode Alpha, savvy investors are turning to smaller and/or emerging managers as they look for alternative sources of return.

We are proud to present Episode 5 of this groundbreaking webinar series with the following carefully screened panel of investment managers:
- Wayne Ferbert, Alpha DNA Investment
- Dennis Jean-Jacques, Ocean Park Investments LP
- Nico Cordeiro, Strix Leviathan
- Michael Azlen, Carbon Cap Management LLP