Newsletter Q4 - 2023

EVOVEST

An eventful year of learning and work ahead

As we begin our 2023 diagnostic, we are beginning to better understand areas of our investment process that need improvement. Our flagship strategy, launched in 2019, is approaching five years of historical returns, giving us a lot of insight into what we are good at and what we need to work on.

Last year was our first negative year in terms of value added relative to the various benchmarks we have, with the Evovest Global Equity strategy underperforming by 5.2% over 2023, most of which occurred when markets were positive, and the volatility gauge (VIX index) was low. At the end of this newsletter, we have the market commentary for each strategy with a proper diagnosis of this underperformance.

Nonetheless, over 59 months, we have an annualized alpha of 3.7% over the benchmark, with slightly lower volatility and a beta of 0.85. By many performance measures, we have performed well relative to our peers, but 2023 was bittersweet. While we are very proud to have surpassed $100 million in assets under management (AUM), we did not deliver the same performance for our clients. While some understand that if you do everything right, given the level of risk associated with an active strategy, a 5% lag in any given year should happen once every 9 years.

As we write these lines, we can observe a strong market reversal in favor of our products in the early days of 2024, reinforcing our view that our investment signals remain relevant.

By working on an improved risk management framework, we can continue to deliver differentiated investment results.

The team is more committed than ever to making a difference and we have made some interesting discoveries in recent weeks.

Improving with an old idea, a customer request, and a dedicated team

A few years ago, we had explored the idea of moving away from a portfolio optimization framework that used a weighted mean to constrain the variance of the various investment factors allowed in the portfolio construction and implementation process. We had a small presentation that highlighted the benefits of moving to a set of distributional constraints to control the various investment risks that we wanted to control.

Following some observations, we made earlier this year about some investment risk exposures; we are testing the implications of this idea to improve the risk management of our strategy. Early results indicate a higher hit rate and the ability to better control tracking error, a measure of volatility relative to a benchmark.

In addition, there have been frequent client requests for portfolio exposure selection relative to the benchmark. By implementing a distribution-based risk control process, we will be able to respond to client requests for greater exposure to common investment risk factors such as value, growth, momentum, etc.

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Our experience with NLP

A working hypothesis over the past few years has been that some investment signals could come from textual data. We wanted to test our hypothesis that raw text data from earnings calls and news should improve our signal. To test this hypothesis, we are developing an experimental path to test a few datasets while working with a postdoctoral student on this topic.

At this point, we have not reached a conclusion that would support our use of this data in our current investment framework. Our research on implementing NLP highlighted some of the fundamentals of machine learning modeling, as the data preparation steps proved to be more challenging than anticipated.

While we haven't found evidence to support the integration of NLP models into our portfolio framework at this time, we have identified key pitfalls when dealing with text data, particularly the need for greater curation of these raw sources, as relevant signals remain difficult to isolate even with the latest NLP techniques. Nevertheless, we see the benefits of this project in developing a reusable toolbox for further research in the future.

Attending key conferences and events

Attending conferences is a key component in building our brand awareness, and we are pleased that our team participated in several of these. We would like to highlight our participation in Cap Intro organized by the Emerging Manager Board in Montreal, EMEX America in New York, the QEMP event in Montreal and the M6 Forecasting conference in New York.

New strategy development

As we continue to look at various opportunities for our growth in 2024, we are excited to incubate some new investment strategies. As we highlighted in our Q3 newsletter, the move to a single global model simplifies the production steps of deploying an investment strategy for a client. With this in mind, we are leveraging these technological advantages to develop new products that we hope will help our clients grow their investments.

Feel free to reach out to us if you have any questions on those.

ABOUT EVOVEST

Evovest is a Montreal-based investment firm using data-driven and human designed techniques to manage equity portfolios. Founded in 2017, Evovest has more than $125 million in assets under management through in HNW and institutional portfolios managed with cutting-edge and evolutive models. Its mission is to bring diversification in equity strategies through an innovative investment process by using AI and machine learning. The firm has seven employees in a streamlined structure that ensures the alignment of interests via ownership. Evovest is B-Corp certified and strives to create a strong sense of community by promoting diversity and inclusivity throughout the firm.

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Market Commentary
Q4 - 2023

EVOVEST

Evovest Global Equity Fund I

The Evovest Global Equity equally-weighted strategy generated a return during the quarter of 6.1% before fees, underperforming its benchmark index by 2.4%. The month of December contributed 0.7% to this underperformance. October and November also weighed on the quarter with underperformance of 1.1% and 0.4% respectively.

Throughout 2023, it was observed that the investment process tends to underperform in periods of low volatility and a bull market, which is consistent with the strategy's historical performance. Since inception, the upside capture ratio has been 97%, but in 2023 it was only 84%. On the other hand, the downside capture ratio reached 92% in 2023, compared to 86% over the entire history.

It is clear that the strategy faced challenges during the year, as the combination of very positive markets and low volatility was not favorable. Factor exposures and stock selection were equally responsible for the negative performance. There was an erosion of value throughout the quarter, culminating in a particularly adverse day following the December FED meeting. Stocks with low residual volatility significantly underperformed on that day.

In terms of stock selection, positions in Rohto Pharmaceutical, Koei Tecmo Holdings, Estee Lauder, First Quantum and Yamaha detracted 1.1% from the benchmark return. Positive contributors such as Raiffeisen Bank, Wayfair, Lasertec, Trelleborg AG and Ypsomed Holding added a total of 1.6%.

A diagnostic is currently underway to plan improvements to the investment process in 2024. A number of options are already being considered to optimize the portfolio construction process, allowing us to better manage our exposure to certain risk factors in line with their observed distribution.

Evovest Global Equity Fund II

In the last quarter of 2023, the Evovest Global Equity strategy, weighted by market capitalization, returned 5.0% before fees, underperforming its benchmark index by -3.7%. The year ended with a cumulative underperformance of 5.7%, in stark contrast to the significant outperformance in 2022. Throughout the year, it was noted that the investment process faced challenges during periods of low volatility or very positive market conditions.

This trend was confirmed this quarter, as the benchmark index rose 8.7% to close the year at 19.9%, compared to 14.2% for our strategy. During the quarter, we saw an erosion of value added, both in terms of factor exposure and stock selection, culminating in a particularly bad day following the December FED meeting. Stocks with low residual volatility significantly underperformed on that day.

Stock selection proved beneficial only in certain European countries, while the combination of selection in the United States and Japan led to a reduction in returns of more than 1.5% relative to the benchmark. Our positions relative to the benchmark were mixed, with stocks such as Whitecap Resources, Chesapeake Energy Corp, Koie Tecmo Holdings and Tokyo Electric Power underperforming, while Raiffeisen International, Kawasaki Kisen, KLA Corp and Carnival Corporation outperformed.

A recurring theme this year, the "magnificent seven," continued to influence the strategy's performance during the quarter. Overall, our often-underweight positioning detracted 0.4% from returns versus the index.

A diagnostic is underway to plan improvements to the investment process in 2024. A number of ways are already being considered to optimize the portfolio construction process, allowing us to better manage our exposure to certain risk factors in line with their observed distribution.

Evovest Global Market Neutral

Over the last quarter of 2023, the Evovest Global Market Neutral strategy generated a return of -2.6% before fees. This negative performance was roughly equally attributable to factor exposures and stock selection. Throughout the quarter, we observed an erosion of added value, which peaked on a particularly inauspicious day following the December FED meeting. Stocks with low residual volatility significantly underperformed on that day.

In terms of specific securities, short positions in SNAP, Burlington Stores, Nuvei, Dexcom and Ocado Group together detracted 1.5% from returns. On the other hand, long positions in First Quantum, Sany Heavy Equipment, Allegro Microsystems, Burberry and China International Capital detracted 0.9%. Among the positive contributors, long positions in Kawasaki Kisen, Raiffeisen Bank, Wayfair, Agilent Technologies and Tokyo Electric Power added a total of 1%. Short positions in United Energy Group, Alstom, Diversified Energy Corp, Flat Glass Group and Lucid Group also added 0.9%.

During the quarter, 352 positions added value, while 323 positions detracted. Thus, 52% of our positions were correctly selected to add value. However, on average, our winning positions returned less in absolute terms than our losing positions (+4.8 bps versus -6.0 bps). This explains the negative performance at the end of the quarter.

A diagnostic is underway to plan improvements to the investment process in 2024. Several options are already being considered to optimize the portfolio construction process, allowing us to better manage our exposure to certain risk factors in line with their observed distribution.