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Research Brief:
All or Nothing - Tough Times for Active Managers

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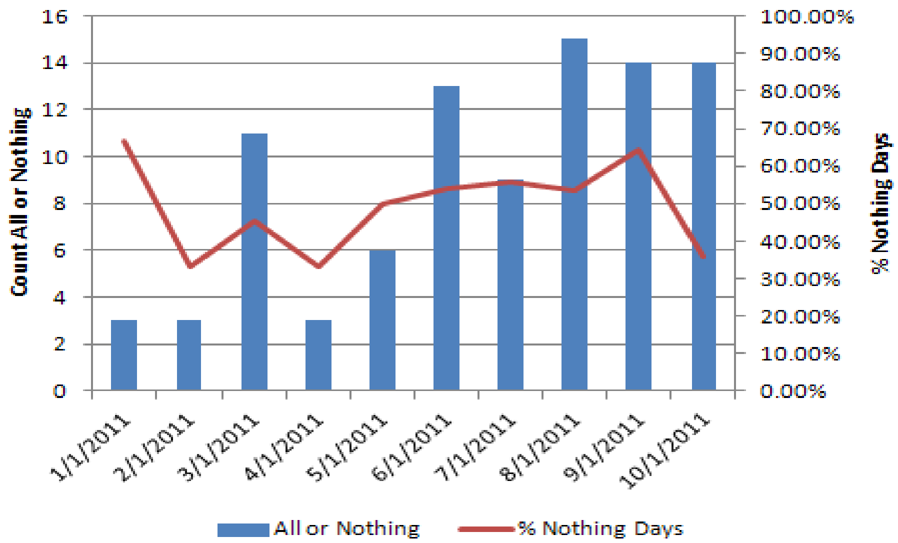
We wrote last month about how the financial market preoccupation with the European sovereign debt crises creates a challenging environment for active equity mangers that have traditionally made their living on stock selection. When investors become singularly preoccupied with common factor risk, the correlation between stocks tend to rise. During periods of high correlations, coupled with low return dispersion, the manager is challenged with increased difficulty in correctly identifying the winners, while at the same time, the margin of outperformance of those winners is tighter than normal.

This month we look at the same phenomena, measured a different way. We simply look at the number of days where 80% or more of the stocks in the S&P 500 have the same sign. We call these days 'all or nothing days'. The number of days where 80% of the stocks in the S&P 500 have negative signs are described as 'nothing days'.

The following chart shows the total monthly number of all or nothing days for 2011. In the month of October alone, 14 of 21 trading days are characterized as 'all or nothing' days

S&P500 All or Nothing Days – January to October 2011



Counts	All or Nothing	Nothing
Year to Date	91	46
3rd Quarter	38	22
October	14	5

Strategy Performance in All or Nothing

We examine 8 common classes of investment strategies and observe their daily correlation to market return. We measure strategy effectiveness by ranking stocks according to several factors that describe the strategy and take the spread of the top and bottom quintile of performance.

The following table illustrates:

- Strategies such as Capital Efficiency are nearly perfectly correlated (-.81) with market direction. In other words, when the marker retreats, these strategies perform well
- When the market rallies, strategies that focus on volatility, and price momentum have performed well.
- Valuation and analyst expectations have shown the weakest relationship, particularly in October to market direction.

Correlation of Strategy Q1-Q5 Spreads with Market Direction – Russell 3000

Factor Theme	July 1 - Oct 31 R3000 w/ Divs		Oct 1 - Oct 31 R3000 w/ Divs	
Analyst Expectations	**0.22**	**	**-0.10**	
Capital Efficiency	**-0.81**	***	**-0.86**	***
Quality	**-0.81**	***	**-0.88**	***
Growth	**-0.41**	***	**-0.57**	***
Price Momentum	**0.65**	***	**0.56**	***
Size	**0.49**	***	**0.70**	***
Value	**-0.32**	***	**0.33**	
Volatility	**0.89**	***	**0.92**	***

** Significant at the 95% Confidence Level
*** Significant at the 99% Confidence Level

OUR RECENT RESEARCH

October 2011: The Banking Industry

Investors can improve model and portfolio risk adjusted returns using various approaches, including incorporating new alpha signals in an existing investment process. In this research piece, we build on our earlier work (See "Is your Bank Under Stress? Introducing our Dynamic Bank Model", November 2010), to determine if bank specific data provided by financial institutions regulatory bodies (FFIEC standardized data), can yield alpha signals orthogonal to those found in most stock selection models.

September 2011: Methods in Dynamic Weighting

In this report, we introduce a powerful discovery tool in Alphaworks and provide a pragmatic survey covering the identification and potential dynamic techniques to handle financial regimes and security level context. With increasingly volatile factor performance, the ability to implement adaptive strategies is paramount in maximizing factor efficacy.

September 2011: Research Brief: Return Correlation and Dispersion - Tough Times for Active Managers

July 2011: Introducing Research Briefs

Investors must sort through a constant stream of information in order to identify opportunities, structural changes, and market risks. Wading through information quickly and efficiently is critical as investors must understand how their strategy and exposures are impacted. Typical classes of questions include: What strategy should I use in response to a regime shift? How do I invest in a specific industry? Do other markets behave differently than the US market?

June 2011: Our Retail Industry Strategy

Does Industry Specific Data tell a Different Story? Investors are on a constant quest for new investment insights. A more complete understanding of the dynamics that shape an industry is integral to this search. As Capital IQ's Quantitative Research begins a more thorough examination of industry specific sources of alpha, we turn our attention first to the retail industry utilizing the Compustat database. Many of the strategies validate common investor best practice when looking at the retail space. In this paper we develop several new retail specific factors and use them to construct a 6-factor retail specific model. We then blend our retail model with our Value and Growth Composite Models.

May 2011: Introducing Capital IQ's Global Fundamental Equity Risk Models

Global investors invest in assets across multiple countries. In order to characterize the overall risk they need the ability to compute the total risk of their entire holdings. Using a global risk model summarizes the risk across multiple geographies into a more easily consumed single number rather than looking at the risk characteristics in isolation for separate geographies. A single global model also captures inter-country correlations so as to not miss important contagion effects.

May 2011: Topical Papers That Caught Our Interest

Favorite Papers on a Few Favorite Topics – Regime Switching and Minimum Variance

Two current topics of significant interest and frequent discussion to investors are regime switching, or a strategy's sensitivity to the current environment, and minimum variance portfolios.

April 2011 – Can Dividend Policy Changes Yield Alpha?

Investors are acutely sensitive to changes in dividend policy. Literature suggests that dividend change announcements provide information about management's assessment of companies' prospects, and therefore are predictive of future stock returns. The implication for investors is worth noting. In the first quarter of 2011 alone, 105 of the 384 dividend paying S&P 500 companies (27.3%) increased their dividends, while only 1 (0.26%) decreased dividends.

In this paper, we analyze the market reaction to different types of dividend policy changes, specifically initiation, increase, decrease and suspension of dividends.

April 2011: CQA Spring 2011 Conference Notes
Several of our team's members attended the Chicago Quantitative Alliance (CQA) Spring Seminar in Las Vegas. We present our collective notes from the conference in this report.

March 2011: How Much Alpha is in Preliminary Data?
Companies often report financials twice: first, through a preliminary press release and again in their official, i.e., final, SEC filings. In theory, there should be no difference between the numbers reported in a company's preliminary financial filings and their final filings with the SEC. In practice, often significant difference can occur between the preliminary and final filings. In this month's research report, we focus on these observed differences within the Capital IQ Point-In-Time database in order to ascertain the nature and exploitability of these differences.

February 2011: Industry Insights – Biotechnology: FDA Approval Catalyst Strategy
Biotechnology is a challenging sector for investors due to the binary nature of the product cycle. Indeed many biotechnology firms' futures rest upon the success of a single product. A critical stage in the product life-cycle is the FDA approval process. In this report we look at the exploitability of a strategy centered on FDA filings.

January 2011: US Stock Selection Models Introduction
In this report, we launch our four US Stock Selection models -- Value, Growth, Quality, and Price Momentum. Built using Capital IQ's robust data and analytics, these four models are the culmination of over two years of research and development. Each model is intended to be employed as the basis for a stand-alone stock selection strategy or integrated into an existing systematic process as an overlay or new component.

January 2011: Variations on Minimum Variance
Various explanations for why risk is mispriced have been offered; the most common one is that leverage restrictions incite some investors to chase volatility at the individual issue level. In this paper, we explore various methodologies for construction of minimum variance portfolios of US listed equities and analyze the features of these portfolios.

January 2011: Interesting and Influential Papers We Read in 2010
As researchers, we spend a large amount of time trying to generate new ideas. In order to discover and refine these ideas, we find ourselves in a continuous quest for innovative and interesting articles and papers from academics, analysts, and other researchers. There is such a large body of information out there that it can be difficult to wade through all the material to find what is truly of value and interest to us. To assist in sifting through all this information, our group recently took the time to find and discuss articles that recently struck us.

November 2010: Is your Bank Under Stress? Introducing our Dynamic Bank Model

October 2010: Getting the Most from Point-in-Time Data

October 2010: Another Brick in the Wall: The Historic Failure of Price Momentum

July 2010: Introducing Capital IQ's Fundamental US Equity Risk Model

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