Reducing the Risks in Equity Investment

Deka Institutionell

The challenge for many institutional investors is how to maintain exposure to the promising returns that equities offer over the long term despite limited risk budgets and renewed market volatility. The focus has shifted away from outperforming benchmarks in bull markets and towards achieving a comfortable return by controlling absolute risks and avoiding extreme losses.

Equity investment provides highly attractive returns as compensation for the provision of risk capital to businesses to finance their productive assets. The higher the perceived market risks, for example from global growth or deflation, the higher the returns required by investors and the lower the levels of equity markets.

According to CAPM paradigm, the market is the only factor or driver that explains the expected return of a stock. However, empirical studies on low-volatility and low-beta stocks have found that these stocks earn above-average returns in the long run. This so-called low risk anomaly is attributed to the behavioral bias of managing relative risks to the benchmark.

Minimum variance portfolios represent an alternative to owning the market portfolio but they simply reduce volatility without distinguishing between good and bad risks. In contrast, our LowRisk approach seeks to invest intentionally in desirable risk positions while avoiding large losses. By applying quantitative research and a multi-factor model, we strive to optimally exploit diversification potential.

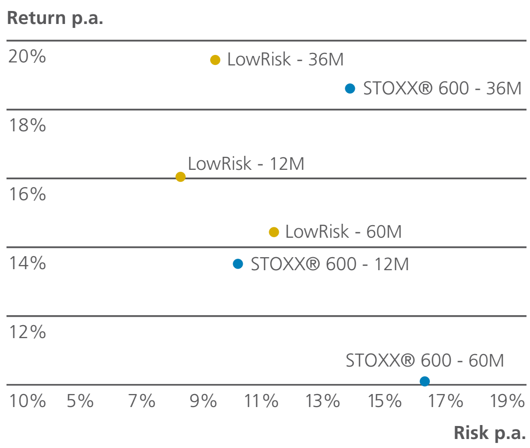
The starting point for our model is the risk aversion factor to estimate the maximum drawdown potential of equities in our universe. This and other factors help us to evaluate different facets of portfolio risk and avoid excessive concentration. We aim to optimize the risk-adjusted return, in terms of the Sharpe ratio, by lowering absolute risks rather than by maximizing returns.

The LowRisk approach is designed to reduce risk by 20-40% compared to a standard market cap weighted benchmark. The low risk anomaly allows for a comfortable return in spite of the defensive allocation. Our live track record since the financial crisis demonstrates that the LowRisk approach delivers significantly higher Sharpe ratios compared to standard market cap weighted equity indices. ■

"Our Deka LowRisk Equity product line is designed to answer client demands for stability, while striving for a superior risk adjusted return."

Dr. Ulrich Neugebauer, Managing Director Deka Investment GmbH and Head of Quantitatives Fondsmanagement & ETF

Return vs. Risk



Source: Deka Investment. 12 months: 30.09.13 to 30.09.14, 36 months: 30.09.11 to 30.09.14, 60 months: 30.09.09 to 30.09.14

Facts and figures

30 %

reduction in risk sought compared to standard market cap weighted benchmarks

2.5 billion

EUR of assets in LowRisk equity strategies

www.deka-institutional.com

Finanzgruppe