



# TexPERS Summer Forum: The State of 130/30 Strategies— Living Up to the Hype?

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August 18, 2008

## Quotes from News Publications

“Although they are too new to have established a consistent performance history, 130/30 strategies as a whole have performed well when compared to both hedge funds and the S&P 500 by a notable margin.”

– Lynn Strongin Dodds, “The Great Debate”, IPE.com, October 7 2007

“It has been argued that 130/30 funds are faddish – just another marketing innovation that benefits the service providers, with clients’ interests as a byproduct.”

– Pirkko Juntunen, “A Matter of Experience”, IPE.com, October 7 2007

# Potential Benefits of the 130/30 Approach

## Traditional active management improved through selective short selling

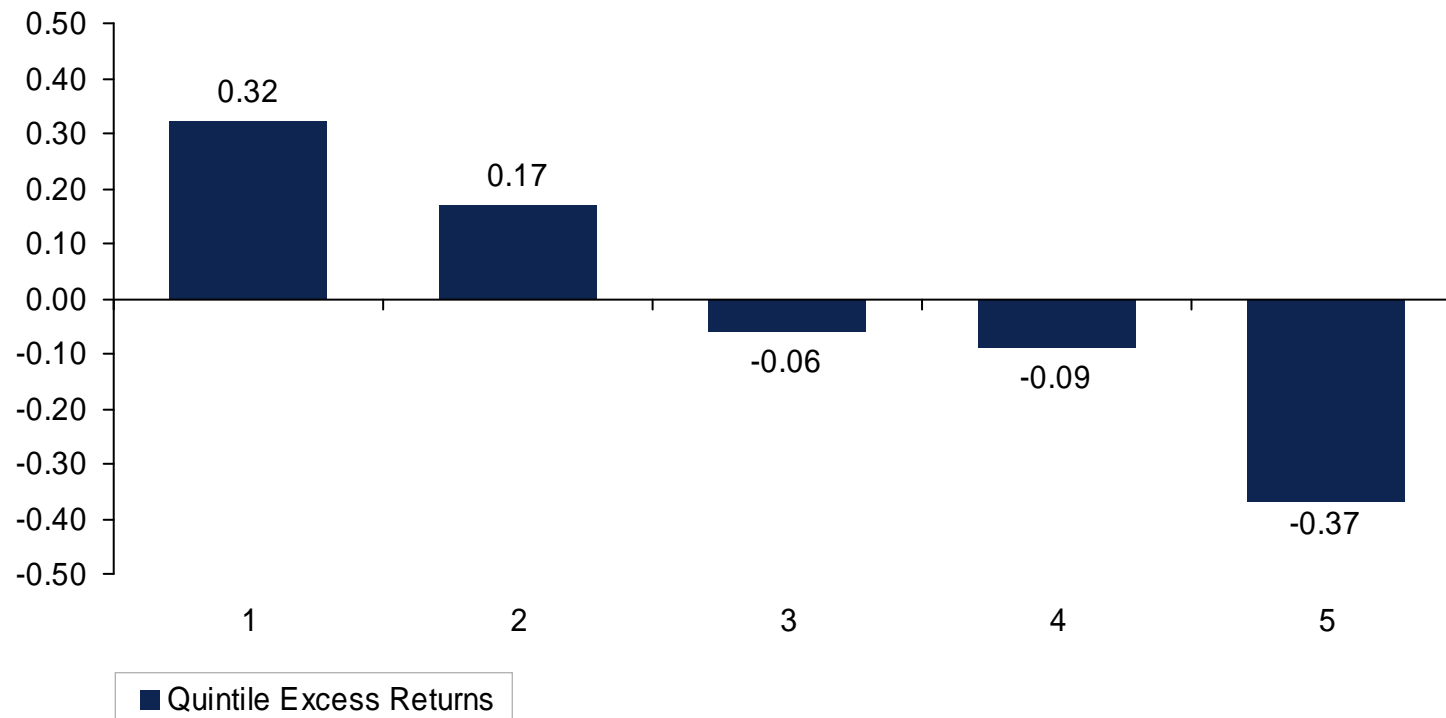
- Increase the active opportunity set
- Improve symmetry of active positions
  - Increased ability to reflect both positive and negative insights into portfolio positions
- Opportunity for higher risk-adjusted returns
  - More efficient use of active risk budget
- Consistent with traditional asset allocation classifications
  - 100% exposure to equity market

Selling a security short exposes investors to the risk that they will be required to buy the security sold short at a time when the security has appreciated in value.

# Quant Models Built for Long Term Success

## One-month quintile excess returns

Hypothetical Example



- 130/30 have been viewed as natural fits for quant process due to scalability

The information outlined above is intended for illustrative purposes only. The information is not intended to be investment advice.

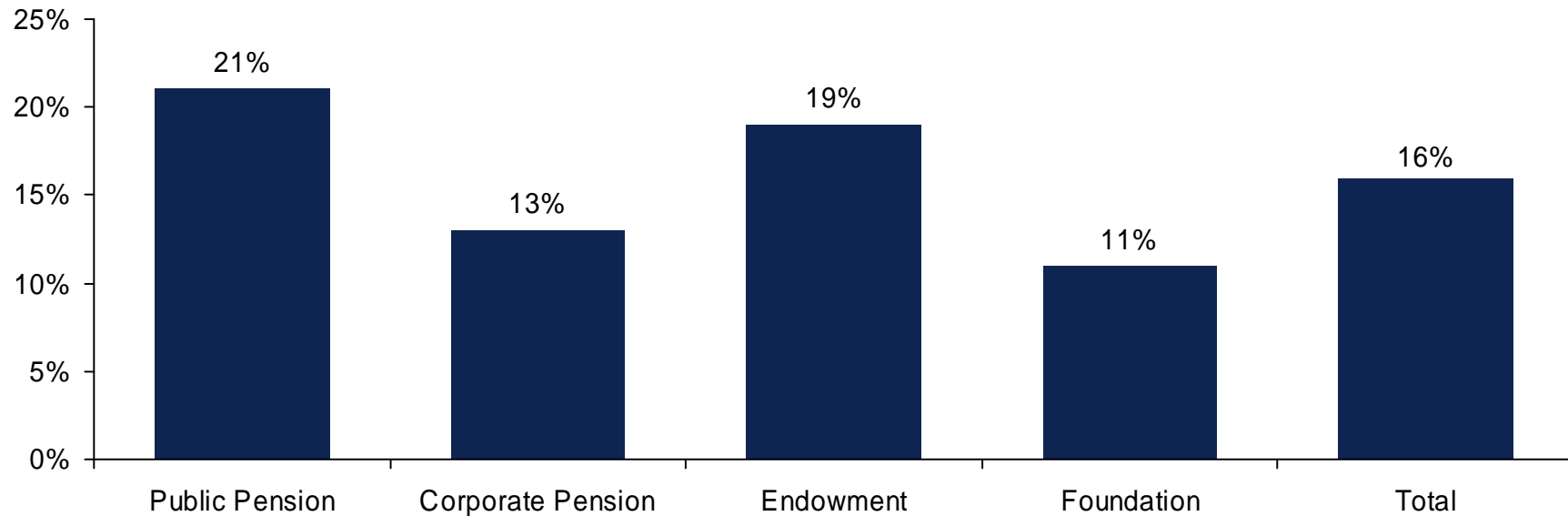
## Strong AUM Growth in 130/30

- Estimated AUM in 130/30-type strategies grew from \$30 billion<sup>1</sup> as of March 31, 2007 to \$66 billion<sup>2</sup> as of March 31, 2008
  - ~\$55 Billion in quantitative strategies<sup>2</sup>
  - ~\$12 Billion in fundamental strategies<sup>2</sup>
- Some market estimates suggest AUM may reach \$100+ billion by end of 2008, and \$300+ billion by end of 2009

<sup>1</sup>Jay Cooper, "130/30 assets surge 77%", *Pensions & Investments*, October 29, 2007

<sup>2</sup>Raquel Pichardo, "Frost forms on 130/30 growth", *Pensions & Investments*, April 28, 2008

# 130/30 Interest Across US Institutional Marketplace



- Survey includes responses from 160 US institutional investors, \$1.5 Trillion total assets
- 1/3 expect to initiate or increase allocation to 130/30 over next 36 months
  - 53% public pension plans, 25% corporate plans, and 17% of endowments and foundations
  - Allocate where? 51% US large cap equity, 23% non-US equity, 17% US small cap equity

Chart Source: Merrill Lynch 130/30 Survey; Latter, Gordon and Haugh, John, "Institutional Demand for 130/30", *Pensions & Endowments*, January 8, 2008

# How has Performance Progressed?

	2005		2006		2007		YTD 2008*	
	#	outperform	#	outperform	#	outperform	#	outperform
Total Strategies	6	50%	16	75%	63	54%	110	65%
-Quantitative	5	40%	12	67%	56	50%	91	71%
-Fundamental	1	100%	4	100%	7	86%	19	32%

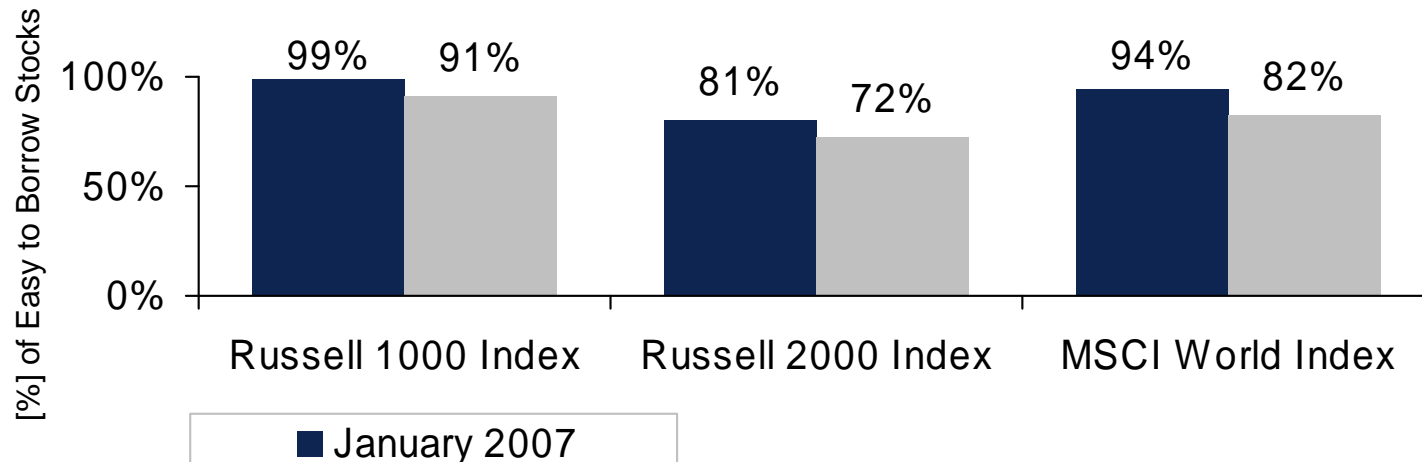
Source: eVestment Alliance, SSGA<sup>1</sup>

\* Through June 30, 2008

- Very small sample of performance to evaluate: it's still early!
- 130/30 strategies primarily quantitative in approach, fewer fundamental strategies
- Performance results mixed in 2007 and YTD 2008

<sup>1</sup>These estimates only include managers with full period of performance in each of the respective periods. Past performance is not a guarantee of future results.

# Has Growth of Strategies Hurt Alpha Opportunities?



- **Easy to borrow stocks reduced – still manageable but needs to be monitored**
- **\$15.3 trillion US equity market as of June 30, 2007<sup>2</sup>**
  - **\$5.6 Trillion (37% of market) lendable assets<sup>2</sup>**
  - **\$800 Billion (5% of market, 13% of lendable assets) on loan<sup>2</sup>**
- **Some research<sup>1</sup> suggests 130/30 increases capacity**
  - **Assuming the same \$ investment and level of risk-adjusted returns, 130/30 has consistently lower dollar holdings per recommended position, thus reducing trading costs and increasing capacity**
- **Capacity is not yet an issue**

Chart Source: Bloomberg, MSCI, as of xx, Morgan Stanley Securities Lending

<sup>1</sup> Zlotnikov, Vadim; Larson, Ann Marie, et al, "Quantitative Research: The Surprising Benefits of the 130/30 Product are Lower Trading Turnover and Magnitude of Risk-Reduction from the Short Positions", *BernsteinResearch*, January 9, 2008

<sup>2</sup> Faulkner, Mark C., "Why Securities Lending Matters to the 130/30 Manager and Vice Versa", Spitalfield Advisors Limited and Deutsche Bank, 2007

## Why Challenging Performance in 2007 for Many 130/30 Strategies?

- Remember: 130/30 approach allows manager to better express viewpoints on stocks
- Greater exposure to stock selection insights
  - Potential for increased risk-adjusted returns when insights are correct
  - Potential for reduced risk-adjusted returns when insights are incorrect
- Many quants struggled during summer of 2007
  - H2 2007 de-leveraging
  - Reinforced importance for unique stock selection signals
- These strategies were developed for long-term success

# Summary

- Small sample and short track record of 130/30 strategies
- Strong theoretical support behind 130/30 approach
- Ample capacity remains to support growth
- Opportunities for skilled fundamental and quantitative investment managers