

# IPM Relishes Return of Volatility

Stockholm (HedgeNordic) – For the past 10 years, IPM has been outperforming the average global macro or CTA manager, while showing no meaningful correlation to either – nor indeed to hedge funds in general, nor conventional asset classes. IPM has also performed well ahead of most systematic macro managers, as measured by Societe Generale's SG Quantitative Macro index.

As IPM marks its 20th anniversary, absolute performance has also picked up dramatically. In the first four months of 2018, IPM's systematic, fundamental macro strategy is up 7.4% in USD. This is already close to the strategy's average annualised returns of 8.6% since July 2006, while volatility of 10.9% has undershot the 15% strategic target. Some 5% of the 2018 return usefully came in the month of February, when IPM's models were well positioned for the market action around the explosion of volatility.

IPM does not trade volatility as an asset class, but has often done well during risk-off episodes. The strategy's best year was 2008 when it gained 30.9%, though its worst year, down 8.1% in 2011, did coincide with the European crisis.

## Markets & Performance Contributors

In 2018, IPM has profited mainly from some big moves in developed market currencies. A contrarian short Swedish Krona position was profitable. "I have seen a number of calls insisting that the SEK is a screaming buy and that the Riksbank must soon raise rates due to Sweden's strong GDP growth." IPM's CIO and Head of Research, Björn Österberg, says "the SEK is very undervalued according to classic measures, and we have the impression that it also is a consensus long, with many fundamental managers expecting mean reversion. But in our models, the negative views based on macroeconomics, risk premia and market dynamics generate signals leading to a short stance versus a basket of currencies". Similarly, IPM's models identify the USD as being overvalued, but once again the risk premia and market dynamics models generate a long position. IPM was also profiting from long of the Japanese Yen. "We were more neutral on valuation for the Yen, but macro and flow dynamics were positive" explains Österberg, who leads an investment team of 14. A short Swiss Franc position also did well, despite a temporary setback in February. IPM's models digest the data without preconceived views on how particular assets should perform in particular market regimes. "IPM prefers to use the same models for all currencies, and does not classify them as "commodity currencies" or "safe haven" currencies" explains Deputy CIO, Mattias Jansson.

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Some managers maintain steady weights in each asset class, but IPM's multiple model signals dynamically adjust its allocations to its three asset classes: currencies, government bonds, and equity indices. "The weighting in relative value bonds has been below its strategic target for some time, as the model generally has identified fewer opportunities in the space. Signals were weak, or offset one another" says Jansson. Now the RV bond bucket has started showing signs of growing, as outlooks have become increasingly negative in the US (pointing to a short Treasury position) vs. German bunds.

In relative value equities, longs in Italy and Spain are based on low valuations and attractive risk

premium, while a short in the US is also partly based on valuation. This spread trade has seen losses as of recent. (IPM's long-only smart beta equities programme, running \$3.3 billion, has a significant value sleeve and some similar positioning).

With 85% of the strategic risk budget in the four relative value strategies (developed FX, emerging FX, bonds and equities) IPM's directional sub-strategy only has 15% of the strategic risk budget. Its biggest position is now short equities, having cut and reversed from long stance. "Though the risk premium remains attractive, valuation and sentiment models lead to a short" says Jansson.

In emerging currencies, the long Turkish Lira position has lost money, even after its strong recovery when interest rates were hiked in May, but the EMFX relative value book is only 10% of the risk budget against 30% for the developed FX relative value book. Elsewhere in EMFX, longs in the Mexican Peso, and shorts in the Brazilian Real and Indian Rupee, have been profitable.

## **Market liquidity**

IPM started trading EM FX in 2013, and has not added any markets to its investment universe since then. Whereas some systematic and quantitative managers are adding dozens of exotic and esoteric markets each year, such as commodities on Chinese exchanges and various emerging market interest rates, IPM does not trade commodities and only trades the most liquid asset class - currencies - in emerging markets. IPM's universe remains more plain vanilla and has even been scaled back in recent years. "We stopped trading Swedish Government debt in 2016 after changes in market structure in addition to generally insufficient liquidity (and the Swiss government bond market is even less liquid than Sweden's)" says Österberg. In European fixed income, IPM trades only UK Gilts and German Bunds, because other markets are not judged to be liquid enough for its style of trading and for risk-weighted assets of USD 5.5 billion in the systematic macro strategy. Liquidity is monitored by the Risk Management Committee and the independent Chief Risk Officer, Elisabeth Frayon.

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If the investment universe has been pretty constant for five years, what does change, albeit incrementally, are IPM's models. Each year, two or three concepts can be added with others refined or updated. "We are trying to extend models, researching volatility as well as additional dimensions in the fixed income space"" says Österberg. Recently, risk premia and market dynamics have been the greatest thematic contributors to returns. Over time, however, a majority of profits have come from the two forward-looking, themes: market dynamics and macro models.

The strategy is typically sitting on cash of 80%, which is now earning a positive return for the USD share class, which is a little higher than the 1.5% management fee. This interest does not generate performance fees for IPM however, because the hurdle rate under performance fees is three-month Treasury bills. The Swedish Krona, Euro, and Swiss Franc share classes are still, of course, seeing negative carry on cash balances.

As Morgan Stanley FundLogic is discontinuing its services to external managers, IPM is setting up its own Irish UCITS structure, into which investors should be seamlessly migrated by year end. "We had a great collaboration with Morgan Stanley, but now that assets have reached \$1.7 billion, we do not need a platform," says Patrik Blomdahl, Director of Investment Strategy.