



Othania Finds Active Application for ETFs

Stockholm (HedgeNordic) - As investors increasingly allocate more capital to exchange-traded funds (ETFs), one may hear more active managers talking about the risks of passive investing. Whereas many associate ETFs with passive investing, there are active applications for these passive instruments too. Danish asset manager Othania illustrates one such application.

Othania, founded by brothers Vincent and Christian Steen Larsen (*pictured*) in March of 2016, manages two funds - [Othania Invest](#) and [Investin Othania Etisk Formuevækst](#) - that use a systematic model to allocate capital either into equity or bond ETFs depending on the degree of risk in equity markets for the month ahead.

Othania's proprietary investment model called Tiger "estimates whether risk levels in the stock market are rising or not for the coming month using leading indicators on economic activity, interest rates, and stock market movements," explains Vincent Larsen. If the model indicates a low or acceptable level of risk in equity markets for the coming month, the two funds allocate the assets managed into ETFs offering exposure to equities. If the degree of risk is high, the capital is allocated to ETFs that offer broad-based bond market exposure for capital preservation.

Othania Goes for ETFs

To run their investment strategy, the Othania team has chosen to get exposure to equities or bonds via ETFs instead of futures or index-tracking mutual funds. Explaining the decision, Vincent Larsen says that “we choose to invest via ETFs instead of futures because our investors feel more comfortable knowing that there are underlying assets behind their investment.” Since futures contracts are highly leveraged instruments, the use of ETFs “makes our investors feel more secure because a lot of them still remember being exposed to leveraged products or underlying synthetic products in 2008.”

The choice of instruments is an essential pillar of Othania’s investment approach, but the ETF selection process is equally important. “Our selection process is based on certain criteria, with one requirement being that the ETFs have to be physically-replicated products for maximum security,” says Vincent Larsen. An ETF’s assets under management and liquidity are two other crucial aspects Othania considers in the selection process.

“The assets of the ETF and the trading flow have to be large enough so that we do not move the price when trading on the month-end,” he continues. “The total expense ratio has to be as low as possible,” adds Vincent Larsen. “Therefore, we usually end up with big names like iShares and State Street as our “go-to” funds,” says the Othania co-founder, stressing that Othania Etisk Formuevækst does also invest in UBS and Deutsche Bank ETFs as these entities “have a better range in the UCITS set-up.”

Product Differentiation, Tiger Model and Track Record

Othania Invest, which is structured as an alternative investment fund, focuses on U.S. equity and bond ETFs. Investin Othania Etisk Formuevækst, a UCITS-compliant vehicle launched in November last year, focuses on global ETFs that consider environmental, social, and governance attributes. These ETFs normally exclude companies producing adult entertainment, alcohol and tobacco products, controversial weapons including civilian firearms, as well as fossil fuels, gambling activities, among others.

Both vehicles use an all-in and all-out rotation orchestrated by the Tiger model. “The key characteristic of the strategy is the aggressive rotations,” argues Vincent Larsen. Each of the two funds makes 12 investment decisions per year,

with the Tiger model's predictions allowing to take a "clear stance on whether equity market exposure is a good or bad investment over a one-month-ahead horizon." The Tiger model relies on three main groups of factors to estimate the risk of being exposed to equities for the coming month.

The first group contains leading indicators of changes in economic activity, namely changes in global commodity prices. "Short-term changes in commodity prices represent a good leading indicator of short-term changes in inflation and growth expectations," explains Vincent Larsen. The second group of inputs comprises changes in the interest curve, whereas the last group includes indicators that provide a "technical assessment of stock market movements." The combination of these three pieces offers a "good understanding of the current risk-perception of the equity market."

Othania Invest has earned an annualized return of 6.3 percent since launching in April 2016 through the end of May this year, whereas the younger fund delivered a cumulative return of 5.4 percent since November last year. Commenting on the older fund's inception-to-date track record, Vincent Larsen says that "even though there have been a lot of political risks with Brexit, Trump taking office, among others, the model's focus on the underlying fundamentals in the economy has really paid off in terms of the right allocation at the right time."