women's month

What is systematic investing, and why is it the way of the future?

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What is systematic investing, and why is it the basis of Prescient's investment strategy?
Systematic investing is a scientific, evidence-based approach that takes the emotion out of investing and allows for better investment outcomes as decisions are based on rules. This mathematical approach offers more science and less art; has a higher success rate; is more predictable and generates higher returns for investors, with lower fees.

At Prescient Investment Management (PIM), we take emotion out of the equation and turn investing into a science instead of an art, allowing us to deliver consistent and predictable results.

PIM's investment approach combines the strengths of passive investments with those of active strategies. Passive investing offers the benefits of low fees, low transaction costs and a low tracking error relative to the benchmark. Meanwhile, active investing provides the potential to deliver additional alpha, representing outperformance of the portfolio relative to its benchmark, while facilitating efficient allocation of capital and capturing market dislocations.

Combining the attributes of passive and active management in this way results in a portfolio with highly efficient market exposure that's cheaper than both active and passive funds but with a consistent performance sweetener.

What is the difference between systematic investing and passive investing?
Systematic investing is a rules-based, active investment strategy while passive investing is a replication investment strategy that aims to maximise returns by minimising buying and selling.

Systematic investing is a rules-based investment strategy whereby the fund manager follows a disciplined process that is evidence-based, efficient and objective. The fund managers do not make short-term forecasts on the direction of markets or the value of individual securities as the evidence suggests that these are extremely difficult to do.

Instead, a sensible long-term portfolio strategy or strategic asset allocation is implemented and then rebalanced when evidence suggests/supports the need to make tactical asset allocation tilts.

Passive investing is an investment strategy that limits the amount of buying and selling within portfolios, making this a very cost-effective way to invest. The strategy requires a buy-and-hold mentality. That means resisting the temptation to react or anticipate the stock market's every next move. Index investing is one common passive investing strategy whereby investors purchase a representative benchmark, such as the S&P 500 index or JSE All Share Index, and replicate it.

What are the misconceptions around systematic investing?
Systematic investing is scientific and quantitative, with many people referring to it as black-box investing because they cannot understand the investment process. This may have been true of the quantitative investment strategies of the past, but we follow a clear investment strategy and process that can be explained and understood at every step and point in time.

How does it compare to fundamental active management?
Active investing refers to an investment strategy that involves ongoing buying and selling

activity by the fund manager. The goal of active money management is to beat the stock market's average returns and take full advantage of short-term price fluctuations. It requires in-depth fundamental analysis and the expertise to know when to pivot into, or out of, a particular stock, bond or asset.

Active investors purchase investments and continuously monitor their activity to exploit potentially profitable opportunities.

PIM takes a systematic evidence-based approach to investing and applies core capabilities across asset classes, not at a particular stock or bond level. This strategy results in a more structured and stable return on investment that is consistently above the benchmark after fees. It offers better risk control by focusing less on stock selection and more on asset allocation. The consistent outperformance of the average manager over short periods results in significant outperformance over more extended periods. And lastly, it allows us to offer competitive fees.

The Prescient Balanced Fund, as an example, aims to deliver performance slightly ahead of average over any 12-month period. It is specifically designed to outperform the ASISA category average of the SA Multi-Asset High Equity, if only by small, consistent amounts so that over the longer term the Fund aims to be at the top of its category.

If it is superior, why has it not taken off in South Africa?
Systematic investing is not as sexy as pinstripes and stock intrinsic value prediction. The South African asset management industry has a history of strong equity markets, driving quite a few asset managers into taking a largely equity-centric view. Adopting an equity-centric approach works during a period of strong market returns – a rising tide lifts all the boats.

In Europe, for example, the industry has experienced a period of muted equity returns, to say the least. This created room for alternative investment approaches and prompted investors to dig deeper. Traditional approaches, like stock picking, have been questioned and challenged more.

With more muted returns in SA over the last couple of years, we are now heading in the same direction. The lower return environment will undoubtedly give rise to more different investment approaches in SA. By applying a detailed analysis on the success rate of what we deem as active stock picking, as well as into the true drivers of returns, PIM believes that asset allocation drives 90% of returns (Brinson, Hood, Beebower: Financial Analyst Journal in 1986) and is confident a systematic approach has a higher probability of achieving success.

Another reason for this approach not becoming mainstream is that computational power and skill is still being developed.

Why is data science so important in systematic investing?
As a systematic manager, we establish principles for what we believe to be sound investment practices, and we program them into our in-house systems. This allows the team to simply trade towards model portfolios and spend the majority of their time improving the process. Unlocking the power of data science is a core component of our investment process.

The PIM investment team is made up of investment professionals with strong data science and economic backgrounds, making them extremely proficient in building and coding big data feeds into our in-house systems. The team's ability to unlock the power of data science by receiving, consuming and computing masses of data daily, is a clear competitive advantage. ■