

PERSPECTIVES

THERE'S BETA IN MY ALPHA!

May 20, 2016

Topics: [Pension Risk Management](#), [Taxable Portfolio Management](#) / Contributors: [Jess B. Yawitz, Ph.D.](#)

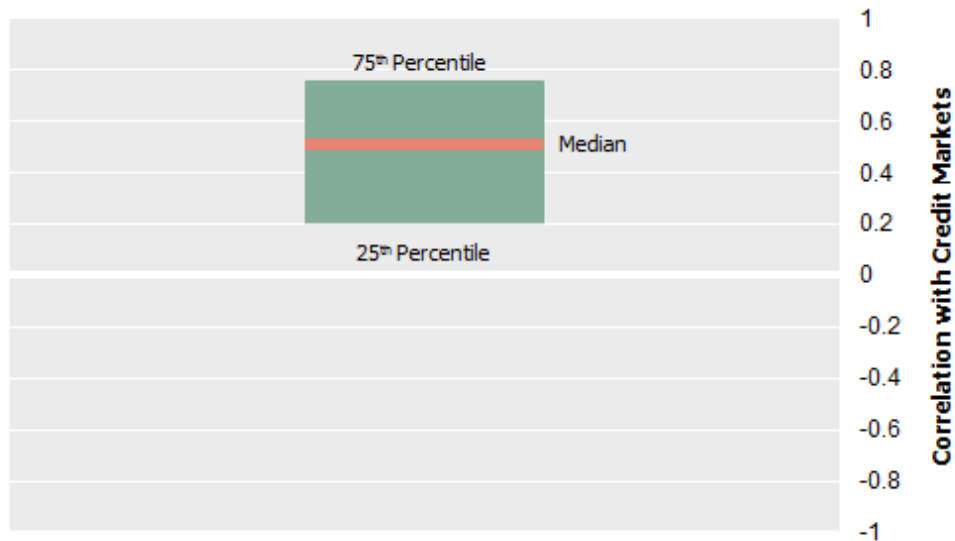


When I was a kid, being called different never felt like a good thing. Fortunately, with age I have come to realize that sometimes being different is good. With that in mind, I share this post – warning, the following is as close to marketing as we will ever come!

It should surprise no one that many active fixed income managers tend to have systematic beta exposure—meaning, they tend to perform well when the overall credit market does well, and underperform when it doesn't. For Long Government/Credit managers, the likely explanation for this relationship is that most managers consistently overweight credit. As a result, they receive the extra return in good times when credit spreads tighten, then lag when spreads widen.

What is surprising, however, is the degree and pervasiveness of this beta exposure. We've analyzed data from the eVestment Analytics database of managers benchmarked to the Barclays Long Government/Credit index. The results are striking. Exhibit I shows the correlation between the performance of Long Gov/Credit managers versus the index and the performance of the corporate bond market. The median correlation is a whopping 0.5.*

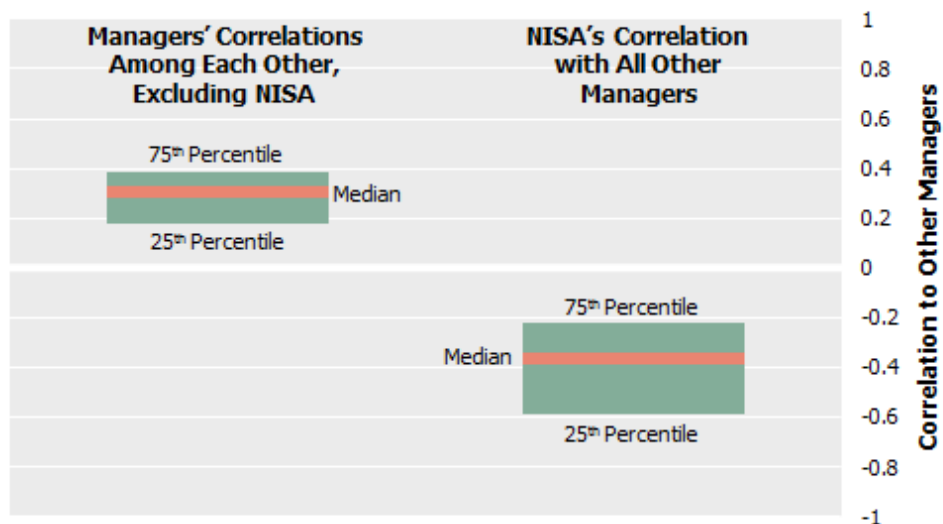
Exhibit I: Long Gov/Credit Managers' Performance - Correlation with Credit, 5-Year Horizon



Source: Based on data from 03/31/11 through 03/31/16 from eVestment Analytics, Bloomberg, and Barclays.

If most managers' outperformance is correlated with the credit markets, it would follow that they will also be correlated to one another. The data bears this out. This first bar in Exhibit II shows Long Gov/Credit managers' correlations to each other (excluding NISA). Their average correlation among one another was 0.3.

Exhibit II: Managers' Correlation Among Each Other, 5-Year Horizon



Source: Based on data from 03/31/11 through 03/31/16 from eVestment Analytics, Bloomberg, and Barclays.

NISA, on the other hand, is generally negatively correlated with most other managers – a median correlation of -0.3. Clients have often described NISA as a style diversifier among their active fixed income managers, and these data clearly make this point.

Having beta in your alpha doesn't necessarily denigrate the strategy. In our opinion it does, however, change the quality of the excess returns. Investors generally desire strategies that are uncorrelated with the large beta positions they naturally hold in their portfolio. The correlation of managers to the market and to each other warrants careful consideration for how best to build a portfolio of active managers.

** There are shortcomings to using databases, including limitations on inclusiveness and survivorship bias. Benchmarks identified in the eVestment Analytics database are selected by the product's investment manager and may not be indicative of the true product benchmark.*

Disclaimer: By accepting this material, you acknowledge, understand and accept the following:

This material has been prepared by NISA Investment Advisors, LLC ("NISA"). This material is subject to change without notice. This document is for information and illustrative purposes only. It is not, and should not be regarded as "investment advice" or as a "recommendation" regarding a course of action, including without limitation as those terms are used in any applicable law or regulation. This information is provided with the understanding that with respect to the material provided herein (i) NISA is not acting in a fiduciary or advisory capacity under any contract with you, or any applicable law or regulation, (ii) that you will make your own independent decision with respect to any course of action in connection herewith, as to whether such course of action is appropriate or proper based on your own judgment and your specific circumstances and objectives, (iii) that you are capable of understanding and assessing the merits of a course of action and evaluating investment risks independently, and (iv) to the extent you are acting with respect to an ERISA plan, you are deemed to represent to NISA that you qualify and shall be treated as an independent fiduciary for purposes of applicable regulation. NISA does not purport to and does not, in any fashion, provide tax, accounting, actuarial, recordkeeping, legal, broker/dealer or any related services. You should consult your advisors with respect to these areas and the material presented herein. You may not rely on the material contained herein. NISA shall not have any liability for any damages of any kind whatsoever relating to this material. No part of this document may be reproduced in any manner, in whole or in part, without the written permission of NISA except for your internal use. This material is being provided to you at no cost and any fees paid by you to NISA are solely for the provision of investment management services pursuant to a written agreement. All of the foregoing statements apply regardless of (i) whether you now currently or may in the future become a client of NISA and (ii) the terms contained in any applicable investment management agreement or similar contract between you and NISA.