



2017 Investment Seminar – Amsterdam
Tuesday, April 25th, 2017
To be held at Grand Hotel Amrâth
Prins Hendrikkade 108
1011 AK Amsterdam
The Netherlands

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Agenda

9:00 Welcome coffee, pastries and Registration

9:30 Welcoming Remarks

9:30 Credit Risk Systems That Read
Chris Kantos, Northfield Information Services

Since the Global Financial Crisis of 2007-2009 history has been marked with numerous failings to correctly assess the credit worthiness of financial instruments, financial institutions and governments. Institutional confidence in the traditional credit rating agencies has been greatly reduced. One of the largest rating agencies, Standard and Poor's, recently agreed to pay a \$1.4 billion fine to US regulators for alleged widespread negligence in the ratings of certain complex financial instruments. As an alternative to the traditional rating process, this work will illustrate the potential use of sentiment statistics from quantified news to calibrate and update the credit risk of corporations and financial institutions in real time. A modified version of the Merton (1974) contingent claims model from diBartolomeo (2010, 2012) is used to break each corporate debt into two pieces, the first considered riskless debt and the second equity in the issuer. We utilize news flows and sentiment statistics to frequently update the expected volatility of the assets of the firm and hence the credit risk of the debt in terms of both the probability of default and loss given default.

10:30 Risk, Uncertainty and Time Horizon: What Most Risk Models Get Wrong!
Dan diBartolomeo, Founder and President, Northfield Information Services

Providers of risk systems often gloss over the most important attribute of any investment risk estimate. It is obvious that all risk of investment performance is in the future. If so, how far in the future: a day, a month, or a century? As we move from the intraday horizons of trading operations to the multiple-decade actuarial horizons of a sovereign wealth fund, the nature of the estimation problem changes profoundly, a fact which risk system providers often prefer to obscure in any effort to present their commercial offering as "one size fits all". In this presentation, we will address several common errors in the modeling process that can greatly impact the validity of risk forecasts. Among these is the failure to distinguish between statistical risk (i.e. a known distribution) and "Knightian uncertainty" (uncertain distribution subject to change). A second error is the assumed shape of factor and asset return distribution in terms of "fat tails" over shorter horizons. Another frequently observed mistake is to include too many factors in the model than the available data can support in an effort to make risk decomposition reports more granular. Finally, the most common problem is the obvious mathematical error of using a relatively short estimation sample period in order to make a model "more responsive" to changes in volatility levels, while annualizing those same time-varying risk assessments under mathematical assumptions that are valid only if volatility is constant.

11:30 Coffee Break

11:45 Minimum Variance Portfolios

Jason MacQueen, Director of Research, Northfield Information Services

There are three basic theoretical ways of building multi-factor risk models for equity markets: by running cross-sectional regressions, given the stock betas, to estimate the factor returns in each period; by running time series regressions, given the factor returns, to estimate the betas for each stock, and statistically, by applying principal component analysis to a stock covariance matrix. In practice, modern risk models are often hybrids, using various combinations of the three methods outlined above. In November 2015, we presented a comparative analysis of the Northfield US Fundamental risk model (a cross-sectional model), the Northfield US Macro-Economic hybrid risk model (APT-based), and the Northfield US XRD hybrid risk model (primarily a time series model). We now consider a different kind of test, by using each of these models to manage Minimum Variance Portfolios over an 11-year period, rebalanced quarterly. Since Minimum Risk portfolios pay no attention to expected returns, this represents a fairly pure test of a risk model. To make the exercise a little more interesting, we have also included a pure Statistical model as well. The results will shed further light on how well the models perform in four different periods: the Low Risk Bull Market from January 2005 to July 2007, the GFC from August 2007 to March 2009, the Recovery from April 2009 to December 2012, and the New Normal, from January 2013 to November 2015.

12:45 Lunch

14:00 Big Data: A Cautionary Comment

Mike Knezevich, Technical Director-Investment Analytics, Northfield Information Services

As the availability of data on all manner of things has exploded in recent years, the investment industry has quickly embraced the concept of “big data” as the next way in which professional investment managers will gain advantage both over their peers, and over purportedly less sophisticated investors. Certainly there have been some investment entities (e.g. the Renaissance organization) that have achieved great success by purportedly recognizing patterns in the flow of events within, and exogenous to financial markets. Simple logic would suggest that the greater the scope of data available to analyze, the greater the number of useful patterns that might be discovered. On the other hand, many organizations that have based strategies on the big data concept have dramatically underperformed expectations. This presentation will focus on the extent to which analytical validation procedures commonly used in the asset management industry are inadequate for big data applications resulting in large numbers of false positive test outcomes, and suggesting numerous avenues for improvement.

15:00 Coffee Break

15:15 Optimal Deal Flow for Investors in Illiquid Assets

Dan diBartolomeo, Founder and President, Northfield Information Services

In recent years, defined benefit plans have greatly increased their allocations to illiquid assets despite the fact that Modern Portfolio Theory has largely avoided the question of what to do with them. In large part, this is not surprising since as their name implies, illiquid assets operate under different conditions than that of their liquid cousins. Having appraisal-based, rather than auction-based pricing, large lumpy assets, and sales cycles often measured in months, rather than milliseconds, are just a few of the differences between these asset classes, and are some of the reasons why illiquid assets have not been as thoroughly addressed in the academic literature. This in turn has made it more difficult for owners of illiquid assets to directly address the fundamental issue facing all investors: what to buy, when to buy, and finally when to sell. Recognizing that owners of illiquid assets cannot take the same path as their stock and bond counterparts, Northfield has developed a solution which merges techniques from fundamental and quantitative finance to tackle this problem in a unique but sensible manner. By fully integrating illiquid asset classes into the same pantheon as traditional holdings, investors can now concentrate their efforts on how to maximize their risk-adjusted returns rather than mulling over the best way to simply calculate their risk-adjusted returns. The research paper underlying this presentation won the 2015 Practitioner Research Paper of the Year Award from the American Real Estate Society.

16:15 Concluding remarks