Northfield's 23rd Annual Summer Seminar

Friday, June 8, 2018

International Tennis Hall of Fame, 194 Bellevue Avenue, Newport, RI

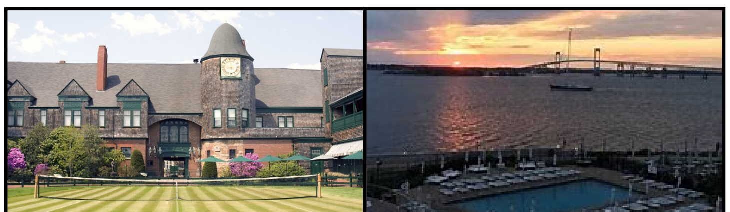
We are pleased to invite you and your colleagues to our annual summer seminar. The purpose of the seminar is to present recent research and technical advances to our clients and friends while enjoying the many pleasures afforded by our unique venue.

Newport has long been a famous sailing center and home of the America's Cup Races, as well as a cherished place to tour. This year we return to the International Tennis Hall of Fame, a venue that will allow us to take advantage of Newport's lovely summer days. The Newport Casino was designed as a social and sporting club and was the center of cultural life for the Astors, Vanderbilts and Newport Society in the "Gilded Age." Designed by Stanford White and considered a masterpiece of Victorian shingle-style architecture, the complex has a picturesque interior courtyard and oriental latticework screens that contribute to the buildings' many shapes and textures. The USTA Wing & Porch provides a private room with an extensive glass wall and doors that open to a 100-ft. long porch overlooking the Casino's horseshoe grass court.

As always, our meeting date has been selected to coincide with the US Professional Championships of Court Tennis. This year's tournament promises to be especially strong with a majority of the top 10 players in the world, including world champion Robert Fahey of Australia and the previous world champion Camden Riviere of the USA. Court tennis is the medieval sport that is the progenitor of all modern racquet sports. Played by royal devotees such as Louis XIV and Henry VIII, it is perhaps the world's most exclusive sport. Quantitative finance professionals will appreciate that due to the complexity of matches, a paid expert is required just to keep score.

After tennis on Friday evening, dinner will be at Gurney's Resort on Goat Island for a waterfront dinner party. We look forward to seeing you!

View from the USTA Wing & Porch overlooking one of the grass courts.



View from Gurney's Resort overlooking Narragansett Bay

Registration, Travel Arrangements and Accommodations

There is no charge for participation in any aspect of this event. We will accept any donation you might care to make on behalf of the Pine Street Inn, Boston's primary homeless shelter. Registrants are responsible for the cost of their transportation and lodging. Please note - we are accepting registrations online only at **http://www.northinfo.com/events.php**. As always, attendees are welcome to bring guest for tennis and dinner. For those planning to spend the night in Newport, ***please remember that this is a BUSY time in NEWPORT and most hotels have very limited space. Gurneys does have limited availability, please contact them directly at (401) 849-2600***. Other recommendations are the Viking Hotel and Newport Harbor Hotel and Marina are recommended, along with the Newport Harbor Marriott and the Hyatt Regency Goat Island. Newport also has many delightful inns: further information is available at **www.newportinns.com**. For all questions, please contact Kathy Prasad at 617-208-2020 or **kathy@northinfo.com.** The deadline for all reservations is May 29, 2018.

International Tennis Hall of Fame
194 Bellevue Avenue
Newport, RI 02840
Phone : 401-849-3990

For more information regarding Tennis Hall of Fame
http://www.tennisfame.com

Gurney's Resorts
1 Goat Island
Newport, RI 02840
Phone: (401) 849-2600

For more information regarding Gurney's
https://www.gurneysresorts.com/

Agenda

8:30 AM **Continental Breakfast**

9:00 AM **Welcome**

9:15 AM **Fixing Active Management: Why Value Investing Works (or At Least *Has* Worked)**

Dan diBartolomeo

One of the most widely accepted concepts in modern equity investing is that "value oriented" active strategies tend to outperform other active strategies. In many cases these strategies appear to produce a statistically significant risk-adjusted excess return, contrary to the expectations of the Efficient Market Hypothesis. We will argue that this apparent anomaly does not arise because value strategies are innately superior. The way in which equity valuation methods are used *has been oversimplified to the point of being consistently and materially biased.* The major result of these biases is that active management as a whole appears ineffective compared to passive strategies. Value strategies are merely the least impacted among popular thematic approaches (e.g. smart beta, factor tilts, etc.) to equity investing, so as to appear superior to other strategies. We will focus on four aspects of traditional equity valuation methods that are the key sources of the bias. The first issue is the *assumption* embedded in classical valuation models (e.g. dividend discount models) that companies exist in perpetuity when they obviously do not. Some companies go bankrupt and many others are acquired for minimal value in periods of distress. The second issue is that projected future cash flows are discounted without regard to the shape of term structure (and the implications of that term structure for forward interest rates). Clearly, the daily operation of bond markets is a clear rebuke to this view. The third issue is the lack of mathematical distinction between mean arithmetic returns and mean geometric returns which is implicit in the single period nature asset pricing models (CAPM, APT). The final issue is that average company level growth projections produced by fundamental analysts routinely imply future levels of national GDP growth that are often multiples of consensus expectation for growth in the economy as a whole. Just as not every child can have above average school grades it is impossible for the average company to grow faster than the economy as a whole in perpetuity. Proper consideration of these issues is highly explanatory of the purported value anomaly through history.

10:05 AM **A Tale of Wynn(ers) and Losers**

Chris Kantos

In December of 2017 Northfield introduced the first commercially available factor risk models that incorporates computerized analysis of news text directly into volatility risk forecasts for individual stocks, corporate bonds, industry groups and ETFs based on market indices. Market events in early 2018 provided several excellent examples of why we believe that *Risk Systems That Read*® is the most significant innovation in factor risk models in more than three decades. We will illustrate show how recent news events drove financial market outcomes for Wynn Resorts, Wynn Macau, Facebook and Wanda Hotels (HK). Each day the content of thousands of news articles are now part of the input for the full range of models available from Northfield. The line of research that led to this innovation stretches back to 1997, and includes five published papers by Northfield staff [diBartolomeo and Warrick (2005), diBartolomeo, Mitra, Mitra (2009), diBartolomeo (2011, 2013 ,2016)]. Beyond the obvious improvement in risk estimation, the method has important implications for alpha generation by both quant and traditional for active managers.

10:35 AM **Coffee Break**

10:55 AM **Replicating Expected Commercial Real Estate Using Liquid Market Instruments and CRE Market-Related Investment Risk**

Emilian N. Belev, CFA, and Richard B. Gold

The purpose of this paper is twofold. First, we estimate forward looking risk and return characteristics of a theoretical commercial real estate portfolio employing real world hedonics with the goal of seamlessly integrating the asset class into a total portfolio risk management system. Because a factor model is at the core of the model's analytics, the model is additive and we are able to calculate estimates at both the property and portfolio levels. Second, we create liquid instrument portfolios that mimic the portfolio's performance in order to hedge the portfolio's risk or simply to gain exposure in the form of direct or collateralized investments in instruments such as stock and bonds whose characteristics would otherwise be unknown if investors were to rely solely on appraisals or index-based risk models. The paper hopes to show, not only what drives real estate risk and return, but also ask the fundamental question about ownership. If liquid synthetic portfolios can be efficiently built with a desired set of risk and/or return characteristics, why own the bricks and mortar? That is the fundamental question that all investors need to both ask and answer.

11:45 AM **Fulcrums, Levers, Pulleys and RAMP: The Northfield Analytics Framework and SAAS Platform - Modern tools for Risk Analytics**

Daniel Mostovoy

This presentation illustrates how financial institutions such as asset owners can enhance their risk management using an online system that is very convenient (e.g. hosted by Northfield) while offering an unprecedented level of flexibility and data security. At the Newport seminar of 2015, Northfield introduced the planned concept of RAMP, an entirely new way of implementing risk reporting and optimizations. In recent years the issue of widespread "data hacks" have had broad impact across financial institutions and society in general. *What makes RAMP unique is that the portfolio holdings of financial institutions are never stored at Northfield, removing the potential for data hacks causing disclosure of confidential investor information.* RAMP queries the original source of the data (e.g. custody accounting systems), loads them into data structures in memory on a secure server, produces the required analytics, *then immediately deletes all the input information, without ever having stored it.* Output reports are distributed through secure processes. This is accomplished using a software framework where analytics processes can be prototyped quickly and put in production as a service. At full implementation, the RAMP environment will offer clients a wide range of Northfield analytics including risk reporting, scenario analysis, stress testing, optimization and our enhanced report suite (now available in MARS-ERM).

12:15 PM **A Newport Luncheon**

1:45 PM **Maximizing RAROC: Turning the "Risk" Unit into a Profit Center**

Emilian Belev, CFA, ARPM

The asset management industry has long been endowed with optimization tools that source their roots in Modern Portfolio Theory which lets risk factors drive returns in a fine-tuned fashion. Banks and other fee-based financial institutions, on the other hand, have historically considered risk from the perspective of the binary dimensions "solvent" (or not) and "regulation compliant" (or not). Due to this role, risk is able to shine only at Doomsday but not in the bottom line of a "boring" non-eventful period profit report. This has allowed politically misinformed language to build up in that space which equates the risk function to increased business cost and impediment to growth, and not see it as an opportunity.

The motivation of this work to dispel this erroneous notion that is harmful to an organization's profitability. This presentation unveils a new approach that is based on award winning work that offers a clear, rigorous, and effective method to optimization of risk adjusted returns that will give risk managers the tools to be the stars of their own show. It applies equally well to an asset manager's portfolio, as well as to a bank's trading or banking book, incorporating distributional moments of all orders while adhering to a preference function that is close to heart to both bankers and money managers. As being distinct from the commonly assumed exponential utility form, it offers a viable alternative, that can replace where the latter is not applicable, or complement, when crosscheck of the robustness of conventional MVO optimization results is necessary. Capturing explicitly the effect of leverage, it is also an attractive framework for hedge fund managers.

2:35 PM **Coffee Break**

2:55 PM **Why Getting Risk Right is Wrong?**

Dan diBartolomeo

Many investment professionals who use risk models make a common mistake. They *assume* that a risk model is working well if the amount of volatility realized by a particular asset or portfolio is consistent with what the model had predicted. They believe that volatility forecasts should be an unbiased estimator of subsequent realized volatility. In this presentation we will provide five different rationales as to why seemingly *unbiased estimates of volatility are undesirable* both statistically and economically. The implications of these arguments are that professional investors routinely take too much risk, back-tests and simulations fail to capture the true risk of strategies, and that evaluation of investment performance is biased toward perceiving luck as skill -- leading to upward biased performance related compensation.

3:45 PM **Court Tennis Demonstration**

4:30 PM **Semi-Final Match, the US Pro Court Tennis Championships**

6:30 PM **Buffet Dinner and Open Bar, Gurney's Resort**