# How Can You Improve Your Portfolio's Capital Protection?

**CHALLENGES**

- Long term: Achieve market-beating results with lower volatility
- Short term: More predictable results and fewer surprises
- Traditional low-volatility approaches may leave more to be

**RESULTS**

- Parametric's Defensive Equity (DE) strategy is positioned to deliver more attractive risk/return characteristics than equity-only portfolios over the long term
- Designed to produce more consistent and predictable outcomes

## Investor Challenge

Institutional investors may need to prepare for and achieve better capital protection in difficult market environments—so they often turn to low-volatility equity strategies.

Over the long term, investors expect these strategies to achieve returns at or above the broad market index with meaningfully lower volatility. Over shorter periods, most would expect to lag the broad market in rallies, stay close in sideways periods, and lose significantly less than the market when equities are heading lower. These types of outcomes would naturally lead to a compression (or reduction) in volatility.

## The Research

The two most common approaches to U.S. equity low-volatility investing can be categorized as risk-metric ranking and minimum variance.

> Both common low-volatility approaches have performed well over the long term versus the broad market on an absolute and risk-adjusted basis—but have done so while experiencing fairly frequent surprises over shorter periods.

**Risk-metric ranking**

- Typically involves sorting an index based on various volatility metrics (e.g. beta, historical volatility, etc.) and selecting stocks in the most attractive (i.e., least volatile) percentiles
- Creates a portfolio with a targeted proportion of names or capitalization relative to the full index
- Associated index: S&P 500 Low Volatility Index (SPLVI).

**Minimum variance**

- Generally looks beyond simple volatility metrics by incorporating correlations among securities and using optimization models
- Creates a basket of holdings with the lowest levels of expected portfolio variance and may apply constraints
- More quantitatively rigorous and may involve some subjective judgments with respect to model inputs—but it is generally accepted that these factors are more stable over time
- Associated index: MSCI USA Minimum Volatility Index (MSMV).

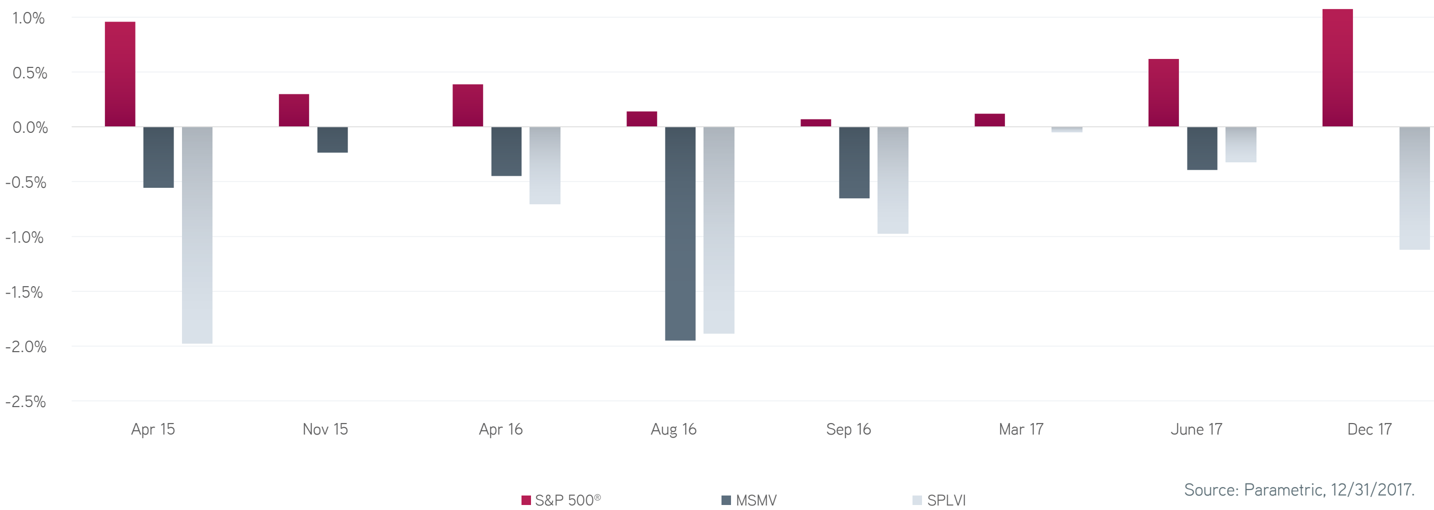
**Our clients want to reduce the frequency and magnitude of short-term surprises, specifically:**

- Downside disappointments – the market was down but the low-volatility portfolio was down more.
- Upside disappointments – the market was up, but the low-volatility portfolio actually produced negative returns.

Our research also found that the portfolio construction processes for SPLVI and MSMV may have inadvertent embedded risk factors (e.g. growth, value, interest rates, etc.) that can significantly impact performance.

When we look at historical performance, we see both SPLVI and MSMV have produced their fair share of surprises.

**Recent Upside Disappointment Events (Market Up, Low Vol Down) – 01/2015 - 12/2017**




Source: Parametric, 12/31/2017.

## Parametric's Solution

While our clients could certainly use the more familiar low-volatility equity strategies, an alternative implementation—in the form of an options-based strategy—is also worth considering. Our non-traditional strategy can be deployed as a complement to or surrogate for today's more typical low-volatility approaches.

> Parametric's Defensive Equity strategy is an alternative framework for creating a low-volatility equity portfolio. It seeks to structurally reduce equity-market risk, while adding a relatively uncorrelated risk premium to enhance returns.

**How it works**

The Defensive Equity strategy pursues two primary objectives:

- Manage risk through portfolio construction – by incorporating U.S. Treasury bills for risk reduction
- Add a relatively uncorrelated risk premium to enhance returns – through the systematic selling of fully collateralized options

## The Results

The Parametric Defensive Equity strategy aims to outperform by following a different path to low-volatility equity investing than SPLVI and MSMV. Our options-based strategy may be reasonably expected to deliver more attractive risk/return characteristics than equities alone over the long term. In addition, using an alternative implementation is expected to produce more consistent and predictable outcomes over time versus comparative indexes.

> Positioned to deliver more attractive risk/return characteristics than equity-only portfolios over the long term

> Designed to produce more consistent and predictable outcomes

Get more Insights and Research on our website at parametricportfolio.com