OPTIMAL
ASSET MANAGEMENT

Dynamic Alpha
Recent "Turbulent" signal switch

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Optimal Asset Management's Dynamic Alpha strategy targets long-term equity outperformance through two distinct features: 1) exposure to factor premia at all times, and 2) a factor timing model that moves systematically in and out of different factor portfolios based on a market volatility signal that indicates whether we are in a "Calm" or "Turbulent" environment.

A few weeks ago, for the first time since May of 2016, our regime signal switched to "Turbulent". In our back-test analysis, we have seen that, in six of the eight prior instances where we have switched to a Turbulent regime, that timing decision has positively contributed to overall performance.

The basic concept of Dynamic Alpha is very intuitive – certain factor premia work well in certain regimes, while other premia work better in other regimes. The ability to "predict" a regime generates alpha by switching into factors that will outperform the cap-weighted market index, provided the regime is anticipated correctly.

Dynamic Alpha switches factors based on a regime indicator, which is derived from a comparison of near-term vs long-term volatility in the market (we believe that volatility is an intuitive and persistent signal, and therefore is a solid foundation on which to build a factor timing strategy). When we see that near-term volatility is above a certain threshold (relative to long-term volatility), we call this a "Turbulent" regime. Otherwise, we are in a "Calm" regime.

Based on these two regimes, we switch between a pair of factor premia.

- An equal-weight blend of Low Vol / High Quality (for Turbulent regimes)
- An equal-weight blend of High Value / High Momentum (for Calm regimes)

Here is how Dynamic Alpha has done in our back-tested study, broken down into the benefit from exposure to factor premia, and the benefit of timing these factor premia, for each regime signal period*:

Regime Period (starting 6/9/03)			Excess Return vs S&P 500 from:		Total Excess Return vs S&P 500
Regime	Period-Ending	# of Days	Factors	Timing	
C	2/12/05	910	30.21%	12.47%	42.68%
T	6/01/06	35	1.05%	-0.37%	0.68%
C	7/07/06	182	2.81%	1.63%	4.43%
T	6/10/06	91	-2.73%	1.11%	-1.62%
C	6/04/07	182	3.28%	0.46%	3.74%
T	6/07/07	91	-0.19%	0.07%	-0.12%
C	3/08/07	28	-0.26%	-0.26%	-0.51%
T	4/07/08	336	2.13%	2.69%	4.82%
C	1/08/08	28	-0.94%	-1.01%	-1.95%
T	5/06/09	308	3.36%	1.66%	5.02%
C	5/08/11	791	6.62%	-0.70%	5.92%
T	3/02/12	182	-0.06%	0.62%	0.56%
C	7/11/14	1,008	8.99%	1.57%	10.56%
T	1/05/15	175	2.44%	-0.30%	2.13%
C	4/09/15	126	1.41%	-0.03%	1.38%
T	6/05/16	245	-1.61%	2.79%	1.18%
C	2/03/18	665	-6.55%	5.60%	-0.95%
T	29/03/18	27 (ongoing)	1.91%	-0.47%	1.44%
Full Period (annualized)		5,410	2.83%	1.52%	4.35%

And here is how this performance has rolled up over the full 14+ year period:

Full Period (Annualized)	Dynamic Alpha	S&P 500
Returns:	13.11%	8.76%
Excess:	4.35%	

Note: Full Period is 6/9/03 – 3/29/18

We at Optimal are always data-driven. We may have our personal views on the market, the economy, and the geopolitical environment, but they do not impact our volatility signal, or our larger portfolio management processes. While nobody knows what the future holds, we felt it was worth sharing with you that, while the world has been talking of increased turbulence, our data is quite dispassionately aligning with that sentiment.

* Attribution to “Factors” is the excess returns over the benchmark of a fixed (i.e. non-timing) strategy consisting of an equally weighted mix of all factor sleeves used by DA. Attribution of “Timing” is the excess returns over the benchmark of the DA strategy minus "Factors" returns.

DISCLAIMER:
RESULTS ARE BASED ON SYSTEMATIC APPLICATION OF A BACK-TEST

All performance examples shown are for illustrative purposes only. No representation is being made that the OAM portfolio will or is likely to achieve comparable performance results to those shown above. In fact, there are frequently sharp differences between a hypothetical performance record and the actual performance record subsequently achieved by live trading.

The investment process described in this illustration is subject to change at OAM's discretion, based on OAM's work with its respective clients to create a suitable portfolio.

Hypothetical, back-tested results were achieved by means of the retroactive application of a simulation model and, as such, the corresponding results have inherent limitations, including:

1)the results do not reflect the results of actual trading using client assets,

2)the results do not reflect the investment of dividends in the same way that an investor might, nor the deduction of transaction, custodial or advisory fees, the deduction of which would have the effect of decreasing model performance results, and

3)back-tested performance may not reflect the impact that any material market or economic factors might have had on the adviser's management of actual client assets.

Not all securities were in existence in the universe throughout the entire time period. In earlier time intervals, the universe of securities may have been different, yielding different performance results.