Follow the flows: Investing according to fund flow data

Franck Fayard, Head of Product Engineering Equity Markets and Commodities (EMC) for Commerzbank in Asia, explained the value of fund flow data and how these vast data pools can help global asset allocation strategies in both equities and fixed income.

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FAYARD WAS SPEAKING AT THE Hubbis Independent Wealth Management Forum in Singapore on March 8. "My presentation is about how to leverage the predictive power of fund flows," he explained.

"Fund flow data presents a huge pool of information, which is both clean and reliable. To explain what we mean by fund flows, these are nothing more than the inflows and outflows of mutual funds and ETFs and across regions, strategies, currencies and the different domiciles of the products".

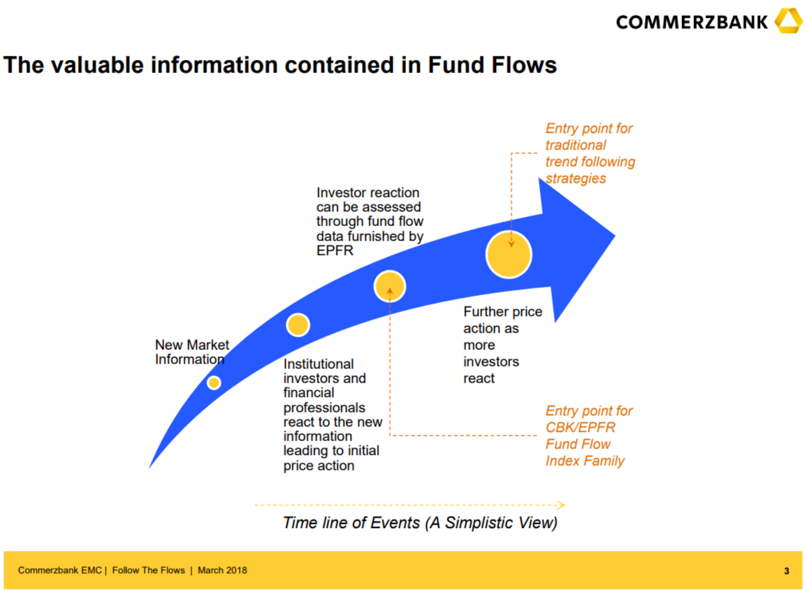
The data Commerzbank uses is based on 15 years of history and today comprises more than $30 trillion of assets, which are growing fast. "Fund flow data can be used to guide asset allocation by leveraging on the valuable information contained in fund flows."

FRANCK FAYARD
Commerzbank

Fund flow momentum strategies are an alternative to the traditional momentum strategies, which are based on price history.

Lagging or leading indicators?

Fayard commented that the data pool is highly reliable, as fund flow



data comes from the fund managers and custodian banks themselves, who would each gain no benefit from tweaking that data. Emerging Portfolio Fund Research (EFPR Global) (the firm with which Commerzbank has partnered for this data pool) receive the data then remove the effects of the currency movements on the flows.

"The question we often get from investors," said Fayard, "is whether fund flowsare lagging or leading indicators? The answer is actually both. When you want to use fund flow data for asset allocation you use past, but very recent data, and you analyse that data in order to identify trends in their early stages, and then you aim to capitalise on that trend for the longest possible time."

The full potential of fund flow data

"We have been analysing how this predictive power can be put into action," Fayard explained. "Accordingly, we have endeavoured to ensure that research into fund flow data and the use of that data in risk and investment indicator strategies has been consistent, always using the same pool of data from the independent firm EFPR Global."

Fayard then explained why this is of great use for HNW clients, as the EAMs and IAMs help manage their portfolios. "Fund flow data can be used for broad allocation, across geographies, sectors and asset classes, but it works best when used for allocation to global equities or for allocation across the sub-segments of US fixed income."

Commerzbank was the first bank to design a family of investible fund flow indices, giving exposure to equities, fixed income or mixed.

"For global equities, we get a pool of five regions that aim to represent 80% to 90% of the global GDP," Fayard added, "and we monitor the inflows and outflows of mutual funds and ETFs which have a core strategy to invest into Europe, the US, UK, Emerging Markets and Japan."

Dynamic, versatile, reliable

"We look at weekly fund flow data, weekly inflows and outflows, because studies have shown that these are the most reliable and relevant data to be followed," Fayard reported. "They are rich in information and they reflect market changes."

Fayard explained further that when using fund flows for asset allocation, investors or portfolio managers must be ready for high conviction strategies. "The systematic strategy that we have developed focuses on the regions that exhibit the strongest capital inflows. Inflows tend to create price inflation and vice versa. When there are no strong capital inflows, to the strategy stays in cash until the next rebalancing date, the following week."

Allocation metrics based on historical data

Fayard noted that the historical allocation numbers for global equities, based on the data for the past decade, would have on average, promoted a portfolio with weightings of 23.6% to emerging markets, 24.7% to Japan, 15.9% to the Eurozone, 9.8% to the US, 6.8% to the UK and cash of 19.2%.

This historical allocation is based on a live track record since June 2015 and was simulated by Commerzbank beforehand.

Fayard concluded his talk by explaining that when focussing upon fixed income, a similar principle to equities should be followed. "The US fixed income market is the largest coherent fixed income market in the world," he reported. "Tracked segments total $524 billion of bonds, in seven segments from US Treasuries to high yield." ■