RQI INVESTORS

RQI Investors frequently asked questions

Established in 2008, RQI Investors is an Australian-based active quantitative global equities firm. We specialise in active quantitative equity strategies across global, emerging markets, Australian equities, and long-short portfolios. Our strategies tune out market noise and identify original investment ideas, tested by robust research, aimed at delivering outperformance against various benchmarks.

With this in mind, we have put together answers to some frequently asked questions about quantitative (also know as systematic) equity investing, the rationale behind it and where it sits relative to some other well-known investment styles.

Frequently asked questions

1. What is the difference between a quantitative and a fundamental equity portfolio?[1]

The differences between quantitative (or systematic) and fundamental equity portfolios come down to the way they are managed and are not always as significant as some believe.

First and foremost, quantitative portfolio managers (or "quants") have the same goal as their fundamental peers – to maximise portfolio returns for a given level of portfolio risk, subject to certain investment constraints.

What is different is the way quantitative managers approach that goal.

A fundamental manager would build an investment case on a single stock, for example. In this case they would, for example, analyse the firm's future revenue potential, its balance sheet, its management quality and its valuation multiples.[2]

A quantitative manager such as RQI Investors on the other hand, will also look at those fundamental elements, but will try and break down each component of an investment thesis and systematically apply it to all stocks in the investment universe. Quants also focus on taking advantage of empirical anomalies that generate returns across a large cross-section of stocks over time. We call these alpha signals. (Please refer to question 4 for examples of alpha signals.)

As a result, while a quant may not always have an informational edge over a fundamental specialist on a given single stock, they may well be able to make up for it by investing and obtaining returns over a larger number of stocks.

Thanks to this wider universe, not only may quant portfolios be better diversified than their fundamental counterparts, they may also have better risk-return optimised[3] characteristics.

2. Is there human intervention in a quantitative approach? Do personal views ever factor into RQI's investment decisions?

There is definitely a "human" component in the RQI quantitative process. These primarily come from the ideas and insights that we use to develop our own unique model, underpinned by a disciplined and transparent research and assessment process.

Our process calls for the evaluation of ideas in an objective fashion. We do not simply add or drop a stock because a member of the investment team doesn't like it. Any insight is evaluated using rigorous testing to ensure that it is applicable in different types of markets and across different regions.

That said, we are investment professionals, not machines, so we monitor our portfolios closely to assess how our insights are being translated into the portfolios to make sure we are achieving what we believe is the best risk and return outcome for our clients.

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1 Fundamental equity portfolio: It involves analyzing a company's fundamental strength through earnings, profit margins, intangible assets, competitive moat, and other factors.

2 Valuation multiples: They are ratios that describe multiple financial factors of a company, providing clear and easily comparable data

3 Risk-return optimized: It involves the process of maximising returns while minimizing potential risks.

There can be exceptions. If a change in an investment characteristic or market environment creates a significant deviation from expectations, we will consider changing our position. We will only ever do this to take risk out of the portfolio, not to put risk in.

3. How does quantitative investing with RQI differ from factor investing?

In factor investing[4], specific characteristics (or "factors") of an investment drive investment decision. At RQI we do use certain aspects of traditional factor investing in some of our portfolios.

For instance, the core value process within our Value strategies assesses factors such as book value, net dividends, cash flows and net sales to help give these portfolios positive exposure to well-established value factors.

However, the RQI process goes beyond these factors to take into account other characteristics or "signals" designed to exploit market pricing inefficiencies.

4. What are some examples of signals RQI uses?

In the context of investing, signals (stock signals) are data points that may foreshadow a change in a share's performance. Different signals can be indicators of positive or negative swings. Investment managers may favour certain signals over others and use them to help decide whether to buy, sell or hold particular shares. We use a number of different signals, grouped into categories of similar insights, including Fundamental Quality, Relative Value, Fundamental Momentum, Market Sentiment, Liquidity Provisioning and Event Driven.

For example:

- Fundamental Quality, includes diversity measures that help assess the management quality of the company. Data shows that more diverse firms are better run firms, so we score firms with greater diversity higher.
- Fundamental Momentum, includes assessing whether the tone of conference calls about earnings is positive or negative. This is driven by our understanding that companies with positive tone tend to have positive future performance.
- Market Sentiment, includes assessing peer-linked based momentum. Here we find peers of firms based on different linkages e.g. customer/supplier or geographical revenue, then look at its performance relative to its peers. If it is underperforming, our view may be that there is potential for some upside opportunity.

5. How do you decide whether to add new, or retire existing, signals?

Our process for adding or retiring signals is rigorous and systematic.

We research new signals based on their economic rationale and subject them to extensive back testing[5] across multiple markets and time periods. Only signals that consistently demonstrate added value across a broad set of conditions are introduced into the alpha model.[6]

Signals may be retired if they show signs of degradation, such as declining efficacy or increasing correlation with existing signals, which reduces their contribution to diversification. While the process is empirical, based on quantitative analysis, it remains flexible to adapt to changing market dynamics.

6. How are the weights for the various signals in RQI's alpha model determined?

An alpha model is a mathematical or quantitative framework used to generate trading signals that can be used in portfolio construction. The weighting of signals in RQI's alpha model is primarily quantitative, determined by their individual effectiveness and contribution to the overall risk-adjusted return.

These weights are optimised through a process that considers each signal's contribution to performance and its correlation with other signals. The weights can vary across regions and sectors due to structural differences in market dynamics. For instance, signals that are more effective in developed markets may be assigned higher weights compared to those in emerging markets.

Although the process is data-driven, the research and portfolio management teams continuously review and adapt the model to ensure the weightings are optimal given current market conditions.

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4 Factor investing: Factor investing involves selecting shares with specific characteristics, or "factors", to achieve higher returns than the market. Examples of some characteristics (or factors) include: value, quality, volume, size and volatility.

5 Back testing: Back testing is when investment managers evaluate a potential investment strategy by running it against historical data to see how it would have performed in the past. This helps them to assess its potential value against different variables in a more current context.

6 Alpha model: Alpha is an investment term that describes the ability of an investment strategy (the alpha model) to beat the market or outperform other investments. Alpha is thus also often referred to as the return over and above the more "normal" or "average" expected return as measured or expressed as a benchmark, when adjusted for risk – that is, its expected excess return relative to the overall risk of the investment in question.

7. **How are RQI's ideas generated?**
Ideas and insights are like the holy grail in our industry. They are hard to find yet yield immense power if, once discovered, they can be used effectively.

At RQI, landing on the best ideas and insights starts with our experienced, diverse team. It then flourishes in a collaborative and flexible environment in which a willingness to embrace ideas is a core value.

We don't have a rigid hierarchy where only "leaders" can be heard. Any member of our team can come up ideas that will be considered by the broader group. Importantly, however, ideas are only developed if they meet the stringent requirements of the tests we apply.

These ideas can come from recent academic work, anomalies team members have observed in the market or from new data sources available in the market.

We believe this constant flow of ideas offers us the best opportunities to land on the innovation and original thinking for which RQI Investors is known.

8. **What can a quantitative strategy bring to a client's wider portfolio?**
A quant strategy provides exposure to differentiated sources of alpha. RQI's strategies use data-driven models designed to systematically capture mispricing and inefficiencies in equity markets, exploiting both short-and long-term opportunities.

By diversifying across a broad range of signals and avoiding behavioural biases, a quant strategy may improve portfolio stability while aligning with the client's broader investment objectives.

Our Value strategies would generally be used where the client is looking for Value exposure. This may be to complement their Growth exposure or to form a part of a Core/Satellite-type[7] allocation.

Our Diversified Alpha strategies are designed as a core all-weather strategy that provides clients with the potential for consistent, risk-controlled excess returns. It would suit a client looking for core exposure.

7 Core/Satellite type allocation: A core/satellite allocation is a form of portfolio construction combining a main or "anchor" mix of assets (the core) along with other, smaller investments (the satellites). Typically, the core is intended to deliver stability or steady performance, while the satellites are chosen for more specific likely performance characteristics to align the portfolio with an investor's particular goals. For example, a core portfolio may be linked to an index to track along with the market, while its satellites are chosen for their potential to deliver above benchmark to boost overall performance, or for their counter-cyclical defensive attributes that may help offset wider investment downturns.

9. How would you expect the quantitative portfolio to perform in various market conditions?

Market conditions can vary significantly from time to time. An essential part of the RQI process is acknowledging and monitoring such changes and seeking to exploit opportunities that may arise as a result, while also avoiding or withstanding the downside over the long term.

Value Strategies

We construct our Value strategies intending them to deliver long term outperformance. However, we also know that very low interest rate and/or very low inflation environments may create headwinds for some value strategies. At the same time, strategies with particular growth characteristics may tend to do better in these environments. To help offset such headwinds, our Value strategies therefore also include better quality and momentum names that share those particular growth characteristics.

In the opposite environment, we tend to expect value to strongly outperform.

In this way we construct portfolios that are intended to weather common market changes while delivering on the strategy goals over the long term.

Diversified Alpha Strategies

For our Diversified Alpha strategies, because we use a diversified set of alpha sources, our expectation is that it is less likely for all factors to underperform at once. Indeed, our aim is to achieve consistent alpha performance.

This is not to say there will not be periods of more muted performance or underperformance, possibilities that are always present in any investment scenario. The intention of our modelling and construction process, however, is to constantly differentiate our alpha sources to make them more idiosyncratic, cushioning the overall effects of major deleveraging or other significant events.

10. Does RQI use algorithms, machine learning and artificial intelligence in its investment process, company selection and portfolio construction?

All of RQI's alpha and model construction processes use what we would classify as "algorithms" and have done for many years.

When it comes to machine learning and AI[8], it's a more complex situation because it's such a broad field. In our view, AI is best considered as a branch of machine learning rather than something separate, at least for now.

We use machine learning extensively in both the alpha construction and selection phase (the model), as well as in portfolio construction. Further, we see this as part of an integrated process in which investment insights are transferred into portfolios, rather than thinking of each phase separately.

That said, there are many specific examples of machine learning or AI tools contributing to our process. We use it to select peers through common features or common valuation metrics, for predicting future earnings revisions, in modelling analyst behaviour, or to trade off alpha characteristics to choose optimal model weights. We use natural language processing extensively to read conference call reports and other text-based information so that this can be consumed within our process.

Once again, we reiterate that the critical parts of our investment process are the ideas and insights that drive it, rather than the tools, of which machine learning is one. While extremely useful and extensively used, in our view, it should never be considered the source of the insight.

Finally, there is the specific branch of AI known as generative AI (for example, chatGPT). We find it is cumbersome to use for alpha modelling. It is however very useful for productivity. Examples include summarising notes or research papers, suggesting code improvements or corrections, writing distilled reports on market conditions or performance which – with human oversight – can feed into client reports.

8 Artificial Intelligence (AI) and Generative AI: Artificial intelligence (AI) is the ability of a computer or robot to perform tasks that typically require human intelligence by analysing large amounts of data, identifying patterns and making decisions based on those patterns. Generative AI systems not only perform tasks, but continue to learn, improve and create (generate) entirely new content.

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Designed by the EMEA/US Design Team – RQI-PC1116-QA gs9