Active Insights Podcast – Algert Global:

The Building Blocks of Artificial Intelligence Have Been Part of Our Process

Diane Merritt:

Welcome to North Square Investments' Active Insights podcast. North Square Investments is dedicated to bringing differentiated active investment strategies to financial advisors and investors through our multi-boutique asset management platform. Today, Mark Goodwin, Chief Executive Officer of North Square Investments, will discuss Algert Global's quantitative approach to fundamental equity investing with Peter Algert, Founder and Chief Executive Officer. Algert Global is a partner firm in the North Square platform and sub-advisor to North Square Dynamic Small-Cap Fund, ticker ORSIX.

Mark and Peter, we look forward to your discussion.

Mark Goodwin:

Thanks. As you mentioned, at North Square we seek out best-in-class active managers for our platform and our partners at Algert Global have a differentiated approach to fundamental equity investing. First, Peter, welcome today.

Peter Algert:

Thanks, Mark. It's good to be here again.

Mark Goodwin:

Peter, Algert Global has managed equity portfolios for about 20 years, primarily for institutional investors. Your investment approach is systematic and data-driven with a focus on stock selection. Can you talk first about your approach to evaluating the vast amount of data in the marketplace as well as how you go about ranking stocks and what characteristics are most important to those rankings?

Peter Algert:

Yes, I'll give you some context because we have been doing this for so long. I think 20 years ago, the answer to that question would be that we start with ideas that make sense to fundamental investors and that we could explain in plain English and systematize them to try and find the essence of those insights that can be exploited repeatedly and systematically. And we test it very thoroughly and we invest as we test. Now, what's happened of course over the last 10 years is the markets have evolved as they always do, and our net that we cast is wider. There is much more data available. We're all aware of the explosive growth of data over the last few decades and the exponential growth, but also our ability to process data, including not just data we might download from traditional data vendors, but data that we get in the form of text that we can have machines read and extract insights.

And our approach is still, we think, embedded in common sense investing, looking for companies that have a sustainable edge of generating economic profits and that are fairly valued given that sustainable edge. Oftentimes that can be a mix of things where a company may have been beaten down and out of favor, and we see it as a good opportunity to invest now versus companies that just continue to perform. And we think that there's a sustainable growth edge that's undervalued by the marketplace. The characteristics that come out of our portfolio might look very similar to a portfolio of 20 or 30 stocks from a traditional investor. We just have those characteristics spread in a much more risk managed way across the large universe of small cap, and in small cap in particular that companies are entering and leaving frequently, there are many companies that are perhaps not familiar to the traditional investment advisors, and I think our ability to ingest data at a very rapid pace across a broad set of insights gives us a strong edge in that space in particular.

Mark Goodwin:

Thanks, Peter. There's been a lot of buzz lately about artificial intelligence, AI, which has sparked a growth rally resurgence in the past few months, and also buzz around Chat GPT and generative AI. Can you talk briefly about the area and the context of systematic investing and how you view the recent attention that's been given?

Peter Algert:

It's a great example of where the attention spikes in the broad population, but what's been going on for decades literally has been well appreciated and understood by academics and serious researchers. And obviously we're all familiar with Chat GPT. And a funny anecdote there is my son, just a graduating senior in high school, he was able to use that generative technology to create a clone of Obama's voice and then script a podcast between himself and President Obama for a high school assignment. And his teacher really thought that was creative and appreciated it. And that is a good example of where that's reaching out to people that may not have been aware of the technology. But we've used elements of machine learning in our statistical processes because we rely heavily on very carefully evaluated and implemented statistical models to extract information from the data we ingest. It's something that's been part of our process, not that large scale generative AI that's part of Chat GPT, but the building blocks of artificial intelligence in general and how you create repeatable signal processing from large scale data. And so, for us, it's not new, it's new to many of the investors, but certainly the companies in the marketplace that are benefiting from that technology and are part of the ecosystem have been around for many years.

Mark Goodwin:

Thanks, Peter. Within the ORSIX fund that you're sub-advising for us, you've been able to generate excellent risk-adjusted returns over time, evidenced by a four-star rating from Morningstar.* Can you tell us about when constructing the portfolio how you balance your return goals with a consideration for risk management?

*North Square Dynamic Small Cap Fund Class I shares was rated 4 stars overall by Morningstar among 596 Small Blend funds for the period ended 6/30/23 based on risk-adjusted performance. For the 3-year period the fund was rated 4 stars out of 596 funds, while for the 5-year period the fund was rated 4 stars out of 551 funds.

Peter Algert:

Yes, and for us it's always about consistent repeatable returns, not just swinging for the fences. We use a very carefully evaluated, tested and developed process and model for making the best use of the insights that we're extracting from data across the large universe of companies that we trade, in a strategy which is over 2000 companies that we can possibly put into the portfolio, in such a way that we try to make sure that if our models are performing the way that we expect them to and that the way they have in the past, then we'll maximize our chance of success without getting tripped up by unexpected events on any one company. And it's really about looking for the consistent repeatable performance and balancing risk across sectors, across the growth and value styles in the marketplace, making sure that we're not taking hidden or unappreciated risk exposures on other systematic factors that can affect stock prices.

Liquidity, for example, we all know that the market seems to go up and down on the latest headline from 30 seconds ago. And we've seen a growing increase in the volatility of what we would call systematic risk factors, and we try to have as little exposure to those as possible because we don't know what the next utterance from a market oracle is going to do to the index level and the moves have been very violent lately. But we do know that the kind of companies we're looking at that have these consistent, repeatable profit metrics that are, we think reasonably valued, if not cheap, and that have growth built into them as well, are going to outperform the market and the other stocks in the market. And we're really trying to build a very balanced portfolio that's not taking large bets on individual sectors or styles in the market, but really exploiting the insights that we see as being underappreciated.

Mark Goodwin:

Thanks, Peter. The US Federal Reserve has aggressively raised interest rates for much of 2022 and into the current year. Inflation has been high, perhaps cooling, and economic growth has slowed. Difficulties in the regional banking sector in the first quarter, as well as geopolitical tensions, have also added to the volatility to start the year, at least. How have these challenges impacted the small-cap segment of the equity market?

Peter Algert:

Thanks, Mark. I think the banking crisis that erupted with First Republic really brought to light the fact that the market needs to be paying attention to how unique this scenario is with rapidly rising rates and inflation still at above Fed targets. From our perspective, we were fortunate that our exposure to the banking group as a whole was limited. We did have some losses in individual names, but this is something we've seen in the past and we know how to risk manage in those scenarios.

I think the broader question of what's happening in the macro cycle with the unprecedented rapid rise in interest rates is going to be a challenge for the market going forward. As you now see, we went through there is no alternative for a long time. The so-called TINA ("There Is No Other Alternative") hypothesis and explaining high equity valuations, but now there are certainly opportunities to extract yield that look quite competitive to equities in the US. From our perspective, we remain fully invested in the strategy. We're there to capture the upside in the market if it continues to rise. And yet we have, we think a very all-weather portfolio, if I can use that phrase, that we think is going to be more protective than the index on the downside.

Mark Goodwin:

Thanks, Peter. Can you discuss your general outlook for equity markets and particularly small caps for the rest of 2023 as well as your longer-term view? I know we are hearing about a soft-landing scenario, perhaps being a likely scenario going forward. And as we discussed earlier, the buzz surrounding has certainly provided a pop to the marketplace. If you give us your outlook in general and then within specific sectors of small cap as well.

Peter Algert:

Yes, this morning I heard the ‘no landing’ hypothesis being bandied about. Soft landing, perhaps no landing, it's, as usual, very unclear where the macro situation is headed going forward. But we continue to encourage people to look at the difference between what's happened with the valuations of small caps versus the large-cap growths. And we know that we've been hammered with the notion that much of the gain in the equity markets in the US this year has been driven by a very narrow set of large cap growth companies. And so, we see the opportunity in small caps is not as different as it was earlier in this year in the sense that the valuations are still quite attractive and even more so on a relative basis to large cap stocks. And of course, for investors with longer horizon holding periods, the equities are still the place to be. Even for non-taxable investors, but certainly, on a tax basis, equities are the preferred source of return for investors, and we see US small caps, in particular, as a very attractive space.

Mark Goodwin:

Are there any sectors in particular where you're seeing outsized valuation opportunities that you can comment on?

Peter Algert:

I think we continue to see opportunities in sustainable growth stocks. One of the stocks that has benefited the strategy earlier this year is Elf Beauty. And that one, it may seem to be at a relatively high valuation, but it's a stock that continues to look attractive to us and remains in the portfolio. We have always fished in a broad-based sense in this universe. We see good opportunities in the healthcare sector in general with much of the biotech and development stage pharma companies. We love to see opportunities and our models have been quite strong in the technology sector and also, in the growthier areas of industrials and consumer sectors. We're not focused on taking a risk in any one sector in particular, but tune the model to take risk where it has been successful and we continue to believe that we have an edge.

Mark Goodwin:

Peter, as we mentioned earlier, Algert Global is the sub-advisor for the North Square Dynamic Small-Cap Fund, ticker ORSIX. You've had excellent performance over the past 12 months and year-to-date. Can you talk about as the markets have shifted over the past 12 to 18 months, how the fund’s investment portfolio might have changed and what the current positioning is?

Peter Algert:

Yes. Our models have moved, not in a jump way, but certainly evolved into a much more of a sustainable quality characteristics are more attractive. And you also mentioned the interest rate cycle. We have developed a number of factors in the last few years, so we look at some of the factors that indicate that the company's financial side is sustainable in the balance sheet. We've developed indicators of whether or not the debt structure is very complicated, which might indicate that their companies are having to give up significant covenants to the lenders to continue to finance their operations and their growth. That's a bad sign to us. We prefer to see companies that are able to continue to raise financing without having to concede significant covenants to lenders. The complexity of the debt structure is an interesting signal for us to use, and it's been a nice addition to the strategy and has been helping us. I think what we see going forward is that we went through the huge growth bubble. Value has come back. The strategy is much more mixed in terms of value and growth characteristics, but the quality part has really been rising.

Mark Goodwin:

Peter, as we discussed, there is certainly uncertainty in the broad economic environment. How do you see an actively managed small-cap equity strategy, like ORSIX, being best positioned in the diversified portfolio of an investor and what are the key benefits?

Peter Algert:

Well, as I said earlier, we think small cap US equities are a great investment opportunity right now and within small cap, we strongly prefer active versus a passive strategy there. And we think that our strategy has added value in the way that we would expect, but the opportunity set is as good as it gets right now for stock selection within small cap. The amount of volatility relative to fundamentals is relatively high. There are price disruptions that occur that create opportunity for entry into positions as well as taking profits. And our models have been very good at spotting those.

Mark Goodwin:

Peter, thank you for joining me today. This has been a great discussion as always.

Peter Algert:

Thank you for the time. We look forward to continuing to deliver performance in the strategy and we'll look to check back in with you in the future.

Diane Merritt:

Thank you for tuning in to our North Square Active Insights podcast. For more information on North Square Investments, our partners and investment solutions, please visit our website at www.northsquareinvest.com.

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As of June 30, 2023, Elf Beauty comprised 2.04% of the portfolio's net assets. The Portfolio is actively managed and current holdings and characteristics may be different. The holdings listed should not be considered recommendations to buy or sell any particular security listed. The holdings identified do not represent all of the securities purchased or sold. Actual portfolio investments may vary when actually invested. A complete list of holdings is available upon request.

LARGEST HOLDINGS (%)

Elf Beauty Inc	2.04%
Medpace Holdings Inc	1.78%
Ufp Industries Inc	1.63%
Teradata Corp	1.56%
Boise Cascade Llc	1.56%
M/I Homes Inc	1.51%
Trinet Group Inc	1.45%
Asgn Incorporated	1.43%
Commvault Systems Inc	1.41%
Manhattan Associates Inc	1.40%

Definition of Terms Used in this Podcast:

Generative AI: Generative AI enables users to quickly generate new content based on a variety of inputs. Inputs and outputs to these models can include text, images, sounds, animation, 3D models, or other types of data.

TINA hypothesis: The acronym "TINA" is often used as a justification for disappointing stock market performance on the basis that other asset classes offer even worse returns.

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