Active Insights Podcast – Algert Global: A Differentiated Approach to Fundamental Equity Investing

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 the unique approach to fundamental equity investing of Algert Global with Algert's Founder and Chief Executive Officer, Peter Algert. Algert Global is a partner firm in the North Square platform and sub-advisor to North Square Dynamic Small Cap Fund, symbol ORSIX. Mark and Peter, we look forward to your discussion.

Mark Goodwin:

Thanks Diane. As you mentioned, at North Square, we seek out the best in class active managers for our platform and our partners at Algert Global truly have a differentiated approach to fundamental equity investing. Peter, good to speak with you again as always.

Peter Algert:

Nice to be here with you, Mark.

Mark Goodwin:

Peter, your firm is very well known among institutional investors, but perhaps less so among retail financial advisors and individual retail investors. Would you mind giving us some background on your firm, the investment team and the investment approach?

Peter Algert:

Certainly. My background, I am a Californian that went to a PhD program at Berkeley and I was very lucky there to meet the faculty that were kind of involved in getting quantitative equity or systematic equity started. Many people don't realize it was actually invented in the Bay area. MS Barra, which became MSCI Barra, and it's the leading risk management platform for equities, was started by a Berkeley prof and there were a number of them that were active in starting some of the seminal strategies in systematic equity firms in the Bay area, Berkeley and Stanford professors.

I got to work with many of them. One of them interestingly was Janet Yellen and I was honestly more in awe of her husband at the time, he only won a Nobel Prize, she actually became the first female Fed chairman. She ended up eclipsing him, but it was good experience to make some connections that became valuable throughout my career.

Now I eventually ended up at Barclays Global Investors, which was one of the early pioneers of systematic equity and was very successful there, but we started our firm in 2003 because the objective there was really to become the biggest. And I wanted to build a firm that was organized around the objective of becoming the best and putting up great returns for clients. We actually started our firm with a hedge fund that focused on small and mid-cap US equities. That's really our background. It's a bug that I caught from my dad when I was a kid and doing the PhD taught me that systematic impact approach to investing was really the best way to generate consistent performance and we learned how to do that well and I was able to recruit a number of like-minded people that wanted to be at a smaller firm that was really organized around performance. And that is the genesis of Algert Global.

Mark Goodwin:

Thank you very much for that, Peter. Your investment approach is interesting in that you use a quantitative or systematic approach. Can you talk about how technology, new and evolving datasets and increased computing power have impacted your approach and evolution to the investing process?

Peter Algert:

It's been transformational. We've had the same philosophy since the beginning, which is that we look to do things that fundamental investors would agree would makes sense, but we just use a different toolkit in getting there. And so 20 years ago, we might've had fairly simplistic models that relied primarily on reported financials that would build traditional statistical models to process that data and rank stocks. And now as with any field, technology has changed and our toolkit is much more sophisticated these days than it was then. And so we literally have a fire hose of data that's not just financial data, but also text data, unstructured data, some of which we buy, some of which we scrape and we process a much broader funnel of information at getting at our stock rankings.

Mark Goodwin:

We've discussed your process in the past of being sort of “quantamental” in nature, where you're using clearly fundamental metrics within the bounds of quant. What do you view as the benefits of quant and some of the asset classes that you invest in, namely small cap equities?

Peter Algert:

I think it's the ability to deal with the amount of data and the breadth of the universe. We're trading 2,000 stocks in this, across the important sectors, the biggest industry in this universe is really biotech stocks. Then you have real estate stocks, you have software stocks, pretty disparate sets of stocks. I think just this earning season, we were processing on some days 500 text documents in addition to all the financial data feeds coming in and you can't really produce a great relative ranking unless you're kind of taking in all that data. If you're just following the 200 stocks in your portfolio and try and keep an eye on what's going out, I think where we win is understanding the nuance of one of our holdings changes relative to all of its competitors.

For example, we process the risk disclosures that companies put in their 10-Qs. It's a text disclosure and now computers can read and they can look for changes from one quarter to the next. We're now getting roughly twice as many companies in the universe producing that risk disclosure after the pandemic, as we did before. And for the ones where we have it, 70% of them changed some of the wording this earning season. How do you know how to interpret that change in risk disclosure in the companies you're following unless you really can systematically assess the amount of change in the entire set of companies you could trade.

Mark Goodwin:

And obviously trying to read 2,000 10-Ks is just not practical.

Peter Algert:

And we humans are very good at scanning and trying to pull out a quick sense of that, but we can actually much more precisely using some of the modern language processing tools, determine the extent of a change relative to all the firms that changed and whether it's a positive or negative change. That's been very helpful for us. It's been very additive to what we do to be able to process all that text. And that's another area where I think some of the modern data science tools have been very helpful to us and we've had a lot of success. What we do is, it really can be expressed really simply. In the case of biotech stocks, understanding that those stocks are very capital intensive and they get IPO-ed and they try to get into an index and the index has to hold them, but most of them honestly will be failures. They're lottery picks and we're able to select a subset of them for the portfolio that we think have a better than average chance of succeeding and turning into the lottery winner. And that's worked well for us.

Mark Goodwin:

And for that industry, as an example, where you have many companies that don't have earnings, so the traditional metrics of PEs and earnings growth don't apply, how do you tackle that type of challenge?

Peter Algert:

We are looking at a broad set of indicators, some of which are technical and a lot of which are what we would call smart money. And it boils down to looking at who are the holders of some of these stocks? Honestly, that's an important input. Are they held primarily by a broad set of index holders and maybe less active investors? Or are they owned by people that only make a living by investing in healthcare and medical technology stocks? You can ascertain some information for that. And certainly the options market signals have been very good for identifying biotech winners as well.

Mark Goodwin:

Thank you, Peter. Over time, how would you say that Algert Global has evolved to maintain its edge over competitors in the quantitative space?

Peter Algert:

At the end of the day, as I said before, our philosophy is the same. We're looking for good companies with underappreciated profit potential down the road, but it's the tools and the breadth of the data have evolved. The amount of money we spend on data this year will be probably four times what it was

15 years ago. And that's just the nature of the beast. We're always looking at new datasets. We probably evaluate, probably get pitched 20 or 30 per year and evaluate three or four of them and maybe take one.

Mark Goodwin:

Peter, I've long been impressed by the variety of backgrounds on your team. Your number of PhDs, obviously, but not all PhDs in finance that you'd expect. And you've got folks with backgrounds in chemistry and math and accounting and physics. Can you talk about the educational backgrounds of the team and how that works well to mesh in creating a very interesting process?

Peter Algert:

Yeah, we've been very successful in recruiting and nurturing talent over the years and for us because we have a completely open culture where everyone is open and critiques all aspects of the investment process, we have to be. Turnover would be bad for us so we're very careful about the culture and part of that secret has been, people want a good platform, a good environment and teammates they can learn from, teammates that they respect their contribution. We've brought in people have PhDs in chemical engineering. We have people with graduate degrees, maybe not PhDs in various forms of computer or data science engineering. We have people with PhDs in accounting, finance and PhD program experience in economics. It's really the kind of merging of data engineering, data science, with an understanding of economics, finance, accounting, is what's allowed us to put common sense, fundamental investing, say even Graham and Dodd style investing, but merge it with modern data science and very carefully done modeling.

Mark Goodwin:

And with respect to the increased data that you're consuming, do you find challenges with respect to being able to store and process that data? Or do you think that the availability of cloud computing has made that to be a non-event?

Peter Algert:

Well, cloud is interesting because it's great for spare capacity. You can scale up as needed, but that's what we use it for. Actually our core computing infrastructure is incredibly high performance and in house which people are often surprised by. I often joke that we're not very smart. We don't have a ton of data. It's not petabytes of data, but we have to read it very often. And the nature of that joke is that we need very high performance IO or storage and it's not truly the case that we're not very smart. But if you're smart, you do very efficient modeling, which means it's very rapid and quick to develop code and do analysis. But that style of work means you need very fast IO.

And we actually bought a device that's an all flash storage array that was incredibly expensive for the amount of storage, but it's super fast. It's from Pure Storage Systems. That's kind of the backbone of our infrastructure and people are surprised that we do use the cloud for kind of slow colder storage and backup storage, but having in house, very high performance infrastructure has allowed us to have very rapid development and testing of ideas, which is an edge for sure.

Mark Goodwin:

Great. Thank you. Peter, you had mentioned earlier that the firm got its roots in the global macro hedge fund arena, but we're partnering on one specific product. You're subadvising our North Square Dynamic Small Cap Fund, a mutual fund with a symbol ORSIX, which focuses on small cap US equities. First, congratulations. The fund has reached a five-year anniversary in September of this year and Morningstar has awarded the fund four stars, owing to its consistent top quartile performance. First, congratulations for reaching that milestone.

Peter Algert:

Thank you very much. And thank you for the partnership. We're very proud of the ability to work with you guys and to generate those returns.

Mark Goodwin:

Could you take a moment and highlight the strategy specifically for ORSIX and talk about the return goals and approach to running the fund specifically?

Peter Algert:

Yes, absolutely. The strategy, as I said, really does focus on the core concept of identifying companies that are good businesses. And this is a cliché, but that are underappreciated either in their sustainability of their profits or on the growth trajectory of those profits. But we go about it using this very large funnel that's sucking in information. We're probably running honestly, tens of thousands of lines of code every night to process that data and update our stock rankings.

We're ranking roughly 2,500 stocks for this strategy every day and updating them as new information comes in. And the goal really is to utilize those rankings, which look at relative values, which look at earning sustainability, which look at sentiment, which looks at data for the options market, the credit market, technical indicators from the equity markets, all of the text filings, the transcripts, the company presentations, pulling features out of them to identify those companies that we think are attractive and build a portfolio that is risk managed relative to those benchmark characteristics that really focuses on our highly ranked stocks. Typically has 150 names give or take 50 that are again, kind of a mix of trying to manage downside risk and downside protection, but take advantage of the information in those stock rankings.

Mark Goodwin:

Thank you, Peter. Over the past several years, perhaps decade, we've seen a massive growth in passive offerings, both in the retail and institutional channels. And sometimes quant is viewed as synonymous with that. How has Algert adapted to this environment? And I know there is the ability to buy generic risk premia and factor signals. How would you describe that you're comparing and contrasting the Algert strategy compared to something that's just flat generic quant passive?

Peter Algert:

Well, yeah, passive, I think is in my opinion, gotten a little out of hand in terms of the amount of money that's passively being invested and it's creating opportunity for active investors. And that's great for us. I always joke that the passive index is kind of the silliest thing in the world because it says you'll take any price as long as it's a closing price you don't care what it is to trade your assets, particularly around small cap benchmark, that rebalances is fairly aggressively every summer. We think that there's tremendous opportunity for us to be able to exploit our stock rankings and avoid some of those overpriced passive holdings in this universe. Crowding is certainly an issue. We have a number of measures we utilize to avoid crowded positions outside of just not just the passive, but also the kind of the quant factor strategies.

We're definitely trying to produce differentiated exposures that don't overlap with well-known generic quant exposures, relative value and things like earnings yield and book to price has been very painful for other investors in the last four years. Low vol type risk premium strategies were very popular, got oversold and now they've had a tremendous draw down and they're still causing some pain for investors. We very much focused on differentiating away from those kind of overly used generic exposures and a lot of the things that we're pulling out of, again, the text document, some of the features. Things like for example, when a company answers questions in its conference call, are they repeating answers that look like sections from the pre-approved script? All earnings calls are approved by compliance and prerecorded. They're scripted. Then you go to the Q and A and the CEO, CFO take questions from analysts.

Oftentimes you can detect that those answers are kind of falling back to a mimicking of the pre-approved compliance language, particularly when they're explaining bad performance and we don't like that. We like it when the answers to questions, look to be uncorrelated with the previous presented material. And that's a feature that we can use. Again, some of these modern data science tools pull out of earnings calls and it will help shade us towards companies that are being a little more open and frank about what's good and bad in their performance versus kind of sticking to the script and being very risk averse.

Mark Goodwin:

Given the growth in passive investment strategies over the past several years and the growth of perceived quants is a expression of passive, how have you continued to adapt and evolve the model to include new signals and evolve it to reflect today's realities and compete against the passive marketplace?

Peter Algert:

Absolutely. We have always said we try to rebuild or replace 10% of the model each year. And I think we've done a pretty good job of documenting that that's kind of the pace of evolution because we know that things, once they become kind of more commonly known or they've been working for a while, they do get bid away. And accounting rules change, regulatory disclosures change. New things are coming in, some things are going out and we've been very dynamic about that. It's a time and variant philosophy. Again, they have to be ideas that would make sense to a fundamental investor, but we're looking to exploit them in a way that has worked in the past and we're convinced it will continue to work going forward.

I mentioned some of the things that we're doing from the transcripts. One of the things we've recently added is a tax aggressiveness signal, which is a function of a new disclosure that's flowing through in some of the fundamental data we give where companies are reporting the potential liability for ambiguous tax liability because of their aggressiveness of their tax accounting. And so we found that that's actually been working very well in this universe. And the other thing that picked up on recently was that there are some features of just as you probably know, companies now, the reporting is very different than it was 20 years ago when they sent the paper copy of the 10-K and Q to the SEC. And there's some information in the XBRL language that companies are incorporating in their tax filings that we've been able to exploit quite successfully in this strategy as well. We're always looking for a new idea and we have a good way of incorporating that in our strategy.

Mark Goodwin:

Great. This year 2020 has been a certainly a tumultuous one for markets starting in the first quarter with the subsequent rapid recovery. At the same time, it's been a year where we continue to see growth outpace value returns and the gap between the Russell 3000 Value to Russell 3000 Growth is maybe the largest year to date in any comparative year. Can you talk about how you've adapted the strategy to current market environments and how you've weathered the storm so well?

Peter Algert:

We could talk ad nauseum about value versus growth. And I think it's important to differentiate between kind of at the index level of say Russell 2000 or 3000 where there's a lot of industry component to that. Whereas in our strategy, we're really thinking about kind of within industry there's relative value still matter in stocks. And for us, we view the U.S. fiscal situation, particularly post pandemic, it's really been shocked. It's almost like we blew our brains out with stimulus. And so many people and we are part of the camp that believe that this will lead to negative real interest rates for a long period of time. This is Ken Rogoff, he's the economist that has been quite active in researching fiscal debt problems of developed economies and emerging economies.

In any case, if you have nominal treasury yields that are below inflation, then essentially the duration of equity valuations gets very long. And it's not about what earnings are in year two, it's about where you get to in a terminal value. And so that really favors growth versus near term relative value. And we think that that will sustain. Am I saying that growth will continue to outperform value at the index level? I'm not willing to bet per se on that, but I do believe that relative value within industries is going to be a poor risk premia in the near future for the foreseeable future. We're focusing much more on what companies can do for sustainable value creation at longer horizons.

Mark Goodwin:

Great. During the periods of high volatility, have you found yourselves using more real time data or newsfeed to try to infuse some real time adjustments to the portfolio at all?

Peter Algert:

No. Our horizon that we like to look at for modeling stocks is really out at least two earnings calls. The high frequency data doesn't enter into our process as much as it might for real short term computerized trading strategies. That being said, we do try to inform the timing of our trades based on shorter term return forecast. And that's a variant of research for us to try and beef up. We've added a number of new factors over the last six months and continue to look at ways to put them together into a more powerful model for timing, the way we get into and out of positions and managing position sizes using information about the near term returns.

Mark Goodwin:

Great. Thank you. With the election behind us and positioning for 2021 unfolding, how do you think about the current tilt or positioning of the Dynamic Small Cap mutual fund for the environment post-election and into 2021?

Peter Algert:

Well, we think we're well positioned. The stocks we have, I think are very core-ish and broad based to various scenarios should be able to outperform. One of the things that we would expect is that there'll probably be some corporate tax rate reversion. And that was when taxes were lowered is very good for companies that pay taxes and have high profits. And if they're raised that we would expect some reversal of that. We'll manage our exposure to that theme. We're not as convinced that there's going to be fiscal stimulus that's going to drive infrastructure and materials type stocks as much as there will be continue to be Fed stimulus in the form of QE and maintaining negative real yields, possibly continuing to buy risky assets and like the Bank of Japan, buying equity.

There seems to be a consensus view building towards equity prices being driven up. And we think that we'll be able to do well if that happens or if it doesn't happen, but we're not counting on a particular amount of stimulus and trying to rotate it into stocks that will be exposed to that. And the other thing I think that's a concern is I'll just add that if people believe that personal income tax rates or capital gains tax rates are going to change next year, then there may be some tax loss and gain harvesting in the remainder of this year and so we're working to make sure that we're not exposed to that if it does happen.

Mark Goodwin:

Thank you. A parallel question to post election is the potential for a COVID-19 vaccine on the horizon soon. You've seen some volatility in some of the stay at home stocks with the positive news of the vaccine showing up in the past couple of weeks. Do you have a view with respect to the potential shifts in the marketplace assuming we have a functioning effective vaccine sometime in 2021?

Peter Algert:

I think we all probably have our views, but it's going to be very difficult to predict how that timeline will play out because as you know, the vaccines will initially be in smaller doses that have to have social justice issues and figuring out how they get distributed around the world. 60% of physicians said that they would take the vaccine, 40% said no, so there's a whole issue of who's going to get it. There's still tremendous uncertainty in terms of what the path would be back to normality. And then some industries look like there will be sustainable changes to their business model for the foreseeable future. It's hard to see airline revenues going back to where they were anytime in the next couple of years.

That doesn't really impact our strategy because we're not taking thematic bets on the pockets of stocks. We're worried more about those kinds of nuance issues of will stocks with positive sentiment suddenly turn negative? And will those stocks that had very negative sentiment as revealed by the measures that we're capturing, suddenly turn positive? Now, fortunately, we're casting such a wide net on data and adjusting data every day that we will pick up those sentiment changes fairly quickly and we'll think we'll be well positioned to adapt as the information changes.

Mark Goodwin:

Great. Peter, thank you so much for joining me today. This has been a great discussion.

Peter Algert:

Thank you, Mark. I've enjoyed it.

Diane Merritt:

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