

How “Quantamental” Combines the Best of Value And Quant Strategies

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To most investment industry observers, quant investing and value investing stand at odds with each other.

Quant-oriented strategies are known to leverage technology to capture many small spreads before human analysts would have the time to parse through the data. Quant strategies generally employ complex black box models that focus on short term inefficiencies with less reliance on company fundamentals.

On the other hand, traditional value investors employ bottom-up security analysis to find opportunities in companies that may be under-valued over a longer time horizon but may have financials that look ugly or appear to be over-valued. Value investors take pride in their deep insight into companies and are often uncomfortable with the notion of trusting computer algorithms to invest without the need to understand a business model or whether a management team is trustworthy.

Despite some level of mutual skepticism, there are plenty of examples which indicate that both styles can sustainably beat the market. Quant investing works because it is empirically tested and employs a uniform process to exploit inefficiencies. Value investing works because after careful study, analysts can identify businesses that are under-valued and gain an information edge or a behavioral edge over a longer time horizon (“time arbitrage”).

Both styles of investing come with limitations and drawbacks.

Quant strategies are most often designed to go after shorter-term opportunities and are therefore not tax-efficient. Quant strategies often rely on better access to data; not only does data become an expensive arms race, but strategies often see their edge erode over time as other firms gain access to data or figure out how to exploit it.

Although bottom-up value managers roughly employ a similar process for each investment, the research process can vary quite a bit from idea to idea which provides managers wiggle room to make exceptions and potentially opens the door to make mistakes. Fundamental investors sometimes fall into the same behavioral traps that they are trying to exploit, for example, by selling when an investment feels too uncomfortable (even if the valuation justifies holding) or over-paying for a company that investors they respect are buying. It is not uncommon for fundamental investors become enamored of a company and feel a need to act on it (buy) as a result of the copious amount of research committed so far. It is very difficult for even the most disciplined investors to consistently avoid all behavioral biases.

At Overlook Rock, we believe there is a huge opportunity to combine the best of both worlds - both quantitative and traditional value techniques. We employ a “quantamental” approach

which seeks to leverage quantitative techniques to invest in a fundamental, value-oriented strategy that emphasizes fundamentals reflective of attractive opportunities.

By employing a fundamentals-driven quantitative process with human oversight, investors can eliminate behavioral biases in an investment process. Furthermore, quantitative techniques can streamline the investment process by more effectively screening the universe for promising investments at a faster pace than possible by human analysts. Technology can empower talented analysts to focus on ways they can add value to an investment process and let computers handle repetitive tasks.

Value investing principles are tried and tested to work. Quants investing with straightforward value models over longer horizons do not have to worry as much about their signals losing effectiveness. And as long as investors are willing to have a longer time horizon, they can benefit from a more tax-efficient return stream.

Essentially, we are asking the question ‘can we combine the best of what humans and computers have to offer and avoid the worst of each?’ We respond with an emphatic yes. Although a system combining human and quantitative inputs must be carefully designed, it has proven to work in several fields (chess, fraud detection, semi-autonomous driving, to name a few).

While there will always be a place for pure quant and traditional bottom-up investing, a new category blurring the lines between the two will increasingly play a role in the public markets. Quantamental investors today can earn excess returns pioneering this emerging category