GAM GLOBAL RATES STRATEGY – SUCCESSFULLY NAVIGATING SOME OF THE TOUGHEST PERIODS IN MARKETS

Marketing material for professional / institutional / accredited investors

Executive Summary

Risk management process is key

Positive returns when many are losing money – 2008, 2018, 2022 and March 2023

Outperformance with lower risk

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2022 and events of recent weeks have once again highlighted the importance of effective risk management when investing.

Many investment managers talk at length about risk management however, the evidence suggests that few seem to implement it effectively. While we do not always get it right, our approach to risk management has resulted in outperformance relative to equities and bonds with smaller month to month drawdowns over the 20 years we have been running the strategy.

In this note we will share the data and conclude with an explanation of our approach to managing risk.

Table 1 provides a summary of the GIPS compliant gross returns for GAM Global Rates Strategy versus returns from the MSCI World Equity Index and the FTSE World Government Bond Index (WGBI). These numbers cover the period since the strategy's launch in January 2004 to March 2023. The Global Rates Strategy has outperformed both indices and the peak month-to-month drawdown has been more modest.

Chart 1: GAM Global Rates Strategy versus major indices (31 January 2004 to 31 March 2023)

	GAM Global Rates Composite	MSCI World Index in USD	FTSE (WGBI) World Govt. Bond Index in USD
Annualized Return (%)	**9.14**	7.84	1-88
Annualized Volatility (%) (standard deviation)	**9.72**	15.64	6.65
Sharpe Ratio (ratio of reward to risk)	**0.74**	0.38	0.05
Sortino Ratio (ratio of reward to downside risk)	**1.28**	0.59	0.08
Maximum Drawdown (%) (largest loss from peak to trough on monthly data)	**-19.50**	-53.65	-27.14
Correlation to GAM Global Rates Composite in USD (Monthly sampling)	**1.00**	0.29	-0.03

Source: GAM Investments. Past performance is not an indicator of future performance and current or future trends. The gross performance does not include the effect of commissions, fees and other charges, which will have a negative effect on the net performance.

GAM Investments

If we examine the more disaggregated data, the profile of returns is also interesting and at times quite different to our peers and from traditional asset classes.

Over the past 20 years there are various periods that stand out as challenging from a risk management perspective. Among them are the financial crises of 2008, 2018 when 90% of all asset classes fell in value; 2020 when Covid hit markets; 2022 when both bonds and equities sold off sharply as inflation picked up and central banks withdrew liquidity; And, more recently March 2023 as concerns over SVB and Credit Suisse rattled markets immediately after the Federal Reserve (Fed) governor had warned of higher interest rates.

How did the strategy perform during these periods and how did it compare with equities and bonds?

Chart 2: GAM Global Rates Strategy performance versus indices during challenging periods

	Global Rates	MSCI World Equity Index	FTSE WGBI
2008	+13.6%	-42.1%	+10.9%
2018	+3.8%	-10.4%	-0.8%
2020	+8.5%	+14.1%	+10.1%
2022	+18.0%	-19.5%	-18.3%
March 2023	+4.8%	+2.8%	+3.8%

Source: GAM Investments.

Investors are always looking for asymmetry. Good risk management should allow us to make more money during good times than we lose during difficult times. The below numbers show the five worst years for Global Rates and the five best years over the past 19 years.

Chart 3: Best five and worst five discrete years of performance for the Global Rates strategy

Worst performance years		Best performance years	
2011	-4.8%	**2009**	+25.7%
2016	-3.4%	**2005**	+22.5%
2017	-1.3%	**2012**	+18.1%
2006	+1.1%	**2022**	+18.0%
2013	+1.4%	**2007**	+17.6%

Source: GAM Investments.

We all recognise that it is not easy to navigate the ups and downs of financial markets. Some years are just very difficult for investors. Unexpected crises, surprising economic outturns or unexpected central bank behaviour are just a few of the reasons why financial markets do not always / rarely behave as expected. Some of these problems can be exacerbated when investing solely in traditional asset classes where investors do not have the ability to go short. This was very clear last year when developed market central bankers belatedly tried to play catch up by raising interest rates faster than many expected. Exogenous shocks or surprises can also catch out the best money managers.

So why does our approach to risk management work? In short, we have the tools (including the ability to go short) and we do as much ex-ante risk management as possible to limit the amount of ex post risk management required. Below are the seven major steps involved:

1. Managing Exogenous shocks

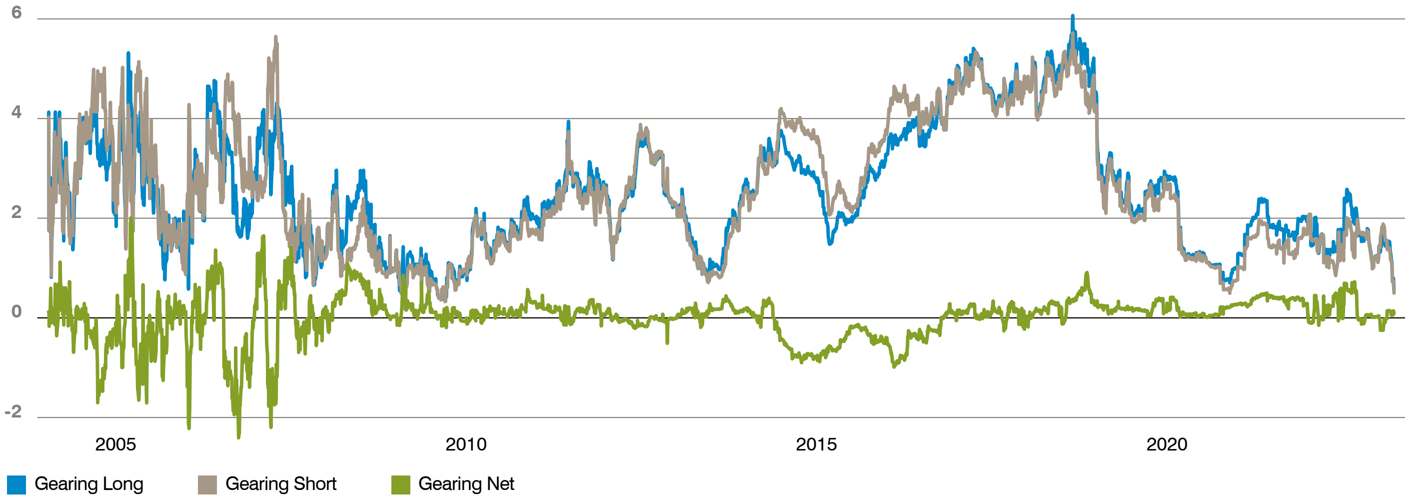
We recognise that often no one knows where the next shock is coming from. These exogenous shocks can derail investments for prolonged periods. Therefore, we try to structure our strategy so that such shocks have a limited impact on returns. A typical long only investor will invariably have exposure to nominal economic growth. This may be through equity, credit or a variety of positive yielding investments. However, when there is a shock to the system that is likely to result in slower nominal growth and higher uncertainty these positions tend to suffer. By focusing on capital gain rather than yield and by running the bulk of our risk as cross-country trades we manage to minimise our exposure to shocks. Investors often seem to underappreciate that yield is there for a reason. Recent events with Credit Suisse were perhaps a timely reminder.

2. VAR and leverage – often misused and misunderstood

A lot has been written about VAR, so we will not repeat it here. But, in short it is a very backward-looking substandard measure of risk that is barely fit for purpose, in our view. In short, it focuses on manageable risks near the centre of the distribution and ignores the tails. It is based of historic correlations and can change in an instant. It has no real information about the risk you may be running tomorrow. Not surprisingly we pay little attention to VAR which we believe can lead to excessive risk taking at just the wrong time.

Leverage is sometimes seen as a dirty word. In the wrong hands it can be dangerous but used appropriately it can be an incredibly effective way of managing and reducing risk. To illustrate the point, a fund fully invested in US treasuries will be more than twice as risky as a fund using double the leverage but being 100% long treasuries and 100% short say euro area bonds. The latter uses double the leverage but, by expressing trades as cross-country risk, reduces its exposure to exogenous shocks. The chart below illustrates how the Global Rates strategy uses leverage to reduce risk and threats from unexpected events. Note that the long positions largely match the short positions. Where they diverge is where we take directional risk which, like last year, is sometimes warranted.

Chart 4: Using leverage to reduce risk – GAM Global Rates Strategy long/short gearing



Source: Bloomberg, GAM, 31 Mar 2023. Note: This chart refers to the GAM Global Rates Strategy since its inception in 2004. Past performance is not a reliable indicator of future results or current or future trends. For illustrative purposes only. The mentioned financial instruments should not be construed as a recommendation to buy or sell securities or investment advice.

3. The right level of diversification

In 1952 Markowitz highlighted the benefits of diversification. But, like so many things it needs to be used appropriately. Like many things in life that are good, diversification exhibits diminishing and negative returns to scale more quickly than many investors may appreciate. The reason for this is that as positions increase, the ability to effectively manage those positions also diminishes. At some point the negatives can outweigh the positives from diversification. Therefore, the Global Rates Strategy takes a focused approach with around eight to 12 themes. On average we end up with say 10 themes and 40-line items. This allows us to get the benefits of diversification while remaining focused enough to be on top of all the risks and be able to adjust our positions as conditions in the market unfold. While we are sympathetic to Markowitz, we also relate to Warren Buffet's comment that "diversification is protection against ignorance". We like to think that we understand the risks we are running.

4. Small team versus big team – remaining in control

This issue links back to the question of diversification. Many investors like to see lots of positions and lots of risk takers under the belief that this minimises key man risk and on the basis that the more managers studying the market the better the return profile. We do not agree with this. In the extreme, the more risk takers, the closer you get to becoming average. You also start to lose control. Our team of three investment managers allows us to fully understand all the risks we are running and to be able to adapt and change positioning when the market environment changes.

5. Correlations – can change quickly

A changing market environment typically means changes in correlations between positions and changes in the risk / reward profile of the strategy. Because we invest in only the most liquid markets, we can have real time price feeds. In addition to the focused nature of the strategy, this allows us to see how the correlations between themes change in response to new information in real time.

6. Trade structure

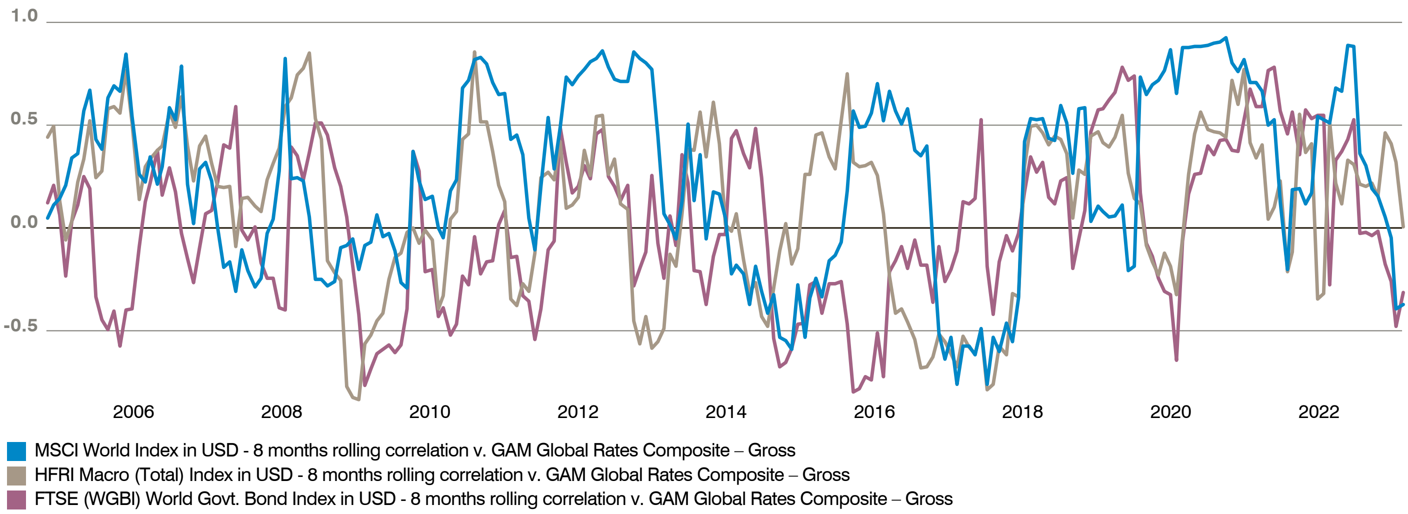
Risk management is always at the forefront of our mind when structuring trades. We want our trades to be driven by the risks we have analysed, not by unexpected shocks. So, for example, if we like say the Mexican peso on specific Mexican grounds we will structure the trade to reflect that. One approach is taking long positions versus other 'risk' currencies such as the South African rand and Brazilian real. While we may give up 'carry' on the trade, such an approach can nullify the impact of exogenous shocks. Of course, selective use of options can also be helpful.

7. Sizing and stop loss management

A lot of time and attention is spent on this area. When we have conviction and the risks are aligned it is important to add enough risk while managing the downside. On all trades we have predetermined stops, often in stages. Stops are placed on individual trades and themes. Stop loss management is an essential tool in investing but it is ex post risk management. You are reacting to something that has not worked. We believe ex ante risk management is always better wherever possible.

So irrespective of whether it is a 'risk positive' environment, a 'risk negative environment' or one like 2022 where bond markets and equities are both down sharply, the Global Rates Strategy can still perform. The chart below shows our rolling and limited correlation with equities (risk) and bonds.

Chart 5: Idiosyncratic trades –> low correlations over short term, long term and crisis horizons



Source: MSCI, Bloomberg, RIMES. Past performance is not an indicator of future performance and current or future trends. The gross performance does not include the effect of commissions, fees and other charges, which will have a negative effect on the net performance.

March 2023 – A closer look at risk and fund positioning

Backdrop

Last month's events have again proven the benefits of effective risk management. In early March at Jerome Powell's semi-annual monetary policy testimony to Congress, the Fed governor suggested the terminal fed funds rate "is likely to be higher than previously anticipated" and that the Federal Open Market Committee (FOMC) would be prepared to increase the pace of rate hikes if data warranted. Interest rate expectations had been increasing since early February and by the time of Mr Powell's testimony, investors were expecting official rates to reach 5.6% by year end. In anticipation of higher US rates, several funds had positioned themselves very short rates. However, within days it became clear that higher interest rates were having a material impact on parts of the banking sector as SVB, and several US regional banks, came under pressure. On top of this Credit Suisse looked to be failing. Within five days investors moved from pricing over 100 bps of rate hikes by December to 100 bps of cuts. Risk in general also came under pressure.

Strategy Positioning

Global Rates had one of its better months in March. This was because our overall duration was close to flat, and the bulk of our risk was expressed via cross country trades. This illustrates points one and two of our risk management approach. Four of the more meaningful positions were:

- Short UK rates versus euro area (front end futures)
- Short Japanese rates versus long US Tips (Japanese swaps versus US Tips)

- Long front-end euro area rates versus equivalent Swiss rates (via swaps)
- Short front end Canadian rates versus equivalent euro area rates (via swaps)

The above trades are primarily being driven by the relative fundamentals and action of the respective central banks – not by exogenous shocks.

In response to some of the intra month moves, we did add some US breakeven inflation positions. We do not see how the market can price rate cuts from the Fed while still hitting the inflation target. And, for a short time 10-year US breakevens got back down close to 2%!

To add to the overall diversification of the strategy, we are also running long positions in Brazilian rates. Although Brazilian rates are 13.75% and one might own Brazilian debt for yield, we are not. We are receiving the fixed rate and paying the floating leg. The trade is in the strategy because we believe that fundamentals are turning, and it is just a question of time before the Brazilian central bank cuts rates, and we benefit from capital appreciation.

Within currency markets. We do not have a carry bias. Again, this is why during a difficult month for risk our currency book has contributed to returns. During March we did have some modest long currency positions in Brazil and Columbia, but we ran these against short positions in Mexico, Chile, and Australia. The net result of such positions was again limited correlation with risk and a positive monthly contribution to returns. In terms of risk management, points five, six and seven outlined above were all relevant.

Outlook

Looking ahead, given the speed at which monetary policy has been adjusted and the varying pace at which various central banks are acting, more risk events can be expected. From where they come it will always be difficult to discern. But having a robust risk management approach will remain essential to navigating such a world.

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