

# BATTERYMARCH

Financial Management, Inc.



## INVESTMENT RESEARCH NEWS



*Mike McElroy (top), the Director of Batterymarch's Global Equity team, has 19 years of investment experience, including eight years in dedicated global equity management. Adam Petryk (bottom), the team's Global Investment Strategist, has 12 years of investment experience, with expertise in applying quantitative strategies across global equity markets.*

*Batterymarch has managed global equity portfolios since 1999, with investments in nearly 50 markets.*

## The Truth about Global Equity Investing

**W**ith the rising interdependence of markets and economies, global equity investing has become more important—and more challenging—than ever. As the global marketplace continues to evolve, investment opportunities around the world have become increasingly complex. A growing number of companies are now listed simultaneously on both US and non-US exchanges. Many firms, regardless of their home markets, have begun to rely on non-domestic business for a substantial part of their revenues.

Dell, the computer hardware manufacturer, is a good illustration of this phenomenon. While headquartered in the US, Dell does business in 30 countries. As a result, comparing Dell solely to other US computer stocks does not provide a meaningful assessment of the company's overall health and prospects. To develop a better picture of the stock's attractiveness, it makes sense to look at Dell from several perspectives, looking at it not just against other US computer companies, but also against its global competitors and other large cap opportunities. A firm like Teva Pharmaceuticals, an Israeli company that gains 80% of its sales from North America and Europe, is best compared to fellow Israel-listed stocks, along with large cap emerging markets securities and other global pharmaceutical companies, both in emerging and developed markets.

This concept is not limited to global businesses. Companies that focus on their domestic markets are also becoming more challenging to categorize. Charles Schwab Corporation, a US-based financial services company that once fit comfortably into the financial sector, has become a major on-line presence, making it an Internet stock as well. Other stocks in the Internet category also fall into more than one sector—Amazon into retail and eBay into consumer services, for instance—again highlighting the need

to look at individual stocks from a variety of perspectives, rather than just within their traditional sector or market groups.

In view of the multiple aspects of so many companies, building a global portfolio is not a trivial undertaking. Successful global equity management begins with a deep knowledge of global markets, coupled with experience managing integrated portfolios whose holdings and construction reflect the complexities of global opportunities.

## **The Advantage of Quantitative Strategies in Global Investing**

Traditional fundamental managers use a variety of sources to evaluate stocks, including public financial statements and earnings announcements. They develop additional insights into a company's prospects by meeting with its management, competitors, customers and vendors, along with government officials and industry experts.

One of the drawbacks to this approach is that, even with a large team of analysts stationed around the world, it's difficult for fundamental managers to closely follow more than a limited number of companies. It is even more difficult for them to research companies using a consistent methodology that can be used to compare stocks across regions. Furthermore, by spending so much time focusing on specific opportunities, fundamental managers can lose objectivity and inadvertently succumb to a compelling stock story, "falling in love" with a stock and continuing to hold it beyond the optimal selling point.

Quantitative managers use much the same information as fundamentalists to analyze stocks. The chief difference between fundamentalists and quantitative investors is not the data they use, but how they gather the information and apply it. Using systematic, quantitative methods, managers can evaluate the full universe of global opportunities while bringing speed, efficiency and uniformity to the stock selection process. They can also readily take advantage of recent improvements in reporting and cross-border comparability.

By analyzing a very large stock universe, quantitative managers can identify and follow many more attractive securities than their traditional fundamental counterparts. Batterymarch, for example, ranks the relative attractiveness of approximately 5,500 global securities every day using consistent, unbiased criteria. A broader investable universe allows managers to construct well-diversified portfolios, reducing the risk associated with investing in fewer stocks. A further advantage is that risk control measures such as liquidity constraints, buy/sell rules and weighting guidelines can be automated by embedding them directly into the quantitative investment process.

At Batterymarch, we recognize the distinct strengths of both traditional fundamental analysis and quantitative techniques. Our unique approach to investment management blends the best of both disciplines by using quantitative techniques to mirror the investment approach of experienced fundamental investors.

Our proprietary quantitative strategy models the investment disciplines of experienced fundamental investors by looking at each stock across the broad measures traditionally used by fundamentalists to analyze companies: Cash Flow, Earnings Growth, Expectations, Technical and Value. It's a rigorous approach that uses essentially the same information and criteria as fundamental investors, with higher speed and efficiency. Furthermore, we apply strict rules in buying and selling stocks, based on

## Global vs. “Global” Managers

The growing popularity of global mandates has led many firms with US and non-US experience to recast themselves as global managers. Today US-based institutional investors can choose from 222 global equity products—a 66% increase since 1999. Determining which managers have the infrastructure and process in place to manage the complexities of global portfolios often goes beyond face value. So what is the true definition of global?

Global research organizations with locations around the world—in New York, London, Tokyo and Hong Kong, for example—may actually be staffed by analysts using inconsistent research methods and valuation standards. Without a unified research and investment process, inadvertent biases at the region or sector level can ensue. In some cases, managers believe that they can build global portfolios by combining two or more regional portfolios. These subportfolios may be managed by separate investment teams, using their own research approaches and processes—also resulting in biases at the total portfolio level. In either case, these “global” portfolios, which are essentially unrelated portfolios fastened together, offer broad exposure but do not encompass the intricacies of global equities as a whole.

As an example, Batterymarch’s research has shown that returns for approximately 67% of global large and midcap opportunities are driven primarily by global sector influences rather than regional dynamics. This finding is supported both statistically and intuitively—for instance, Energy, Materials and Technology stocks are more subject to global influences than Utilities and Retailers securities, whose returns tend to reflect regional stimuli.

Truly global managers view global equity investing as a specialized asset class with unique challenges related to stock selection, portfolio construction and risk management. These managers understand the need to know whether it is the region, country or sector that is driving returns—or perhaps all three—and can systematically apply this thought process to thousands of stocks across dozens of countries. They have developed this capability by establishing the infrastructure and resources necessary to construct integrated global portfolios. This approach is characterized by a dedicated and experienced global investment team using a consistent investment process that incorporates global-based research and multiple risk controls.

their daily rankings, to ensure that all investment decisions are made according to consistent, objective standards.

### Solving the Global Puzzle

Global managers who are best positioned to add value on a long-term basis already have all the pieces in place, including years-long experience in world markets. Their expertise consists of much more than a thorough understanding of multiple markets—it includes proficiency operating in a framework for building integrated global portfolios.

#### *Dynamic, Unified Approach*

To analyze opportunities effectively using consistent, unbiased criteria, the successful global team must use a common research platform and investment strategy designed to efficiently capture and capitalize on the complexities of global investing.

Batterymarch’s quantitative process, for example, is customized for individual regions, markets and sectors, each with its own driving forces and characteristics. We rank stocks from multiple

viewpoints—within intuitive, common-sense peer groups based on sector, market cap size, style, risk and industry—to incorporate the full gamut of investor perspectives. This focus on multiple peer groups was prompted by our proprietary research, which demonstrates that stock rankings based on multiple peer-group comparisons can lead to higher, more stable returns over the long run.

Since markets continuously change, even during periods of relatively low volatility, a global investment process must be dynamic. At Batterymarch, we retest our stock selection model monthly to confirm that each component continues to add value. This allows us to recalibrate the model as needed to capture any differences in the investment environment.

#### *Global-Based Risk Control*

Stock selection is the primary component in adding value for global mandates. But adept managers also take steps to preserve portfolio alpha through integrated risk management. Controlling for risk from a global standpoint is more intricate than for less broad-based portfolios.

As with stock selection, global managers must look at risk from multiple perspectives, determining optimal exposures and constraints for the portfolio not only at the security level, but according to regions, countries and global sectors. They must also determine market cap and currency exposures. Portfolio optimization, using a risk model, is the most effective way to balance these variables to help control for risk while producing attractive returns. It is especially important to use a risk model that is designed to easily adapt to on-going changes in the investment landscape.

#### *Extended-Hours Global Trading*

Both necessity and the advent of worldwide communications and technology have elevated global trading to a more complicated, ever-changing arena. With markets continuously open, the competitive advantage goes to managers with global trading capabilities, extended hours and experienced global traders who can control information and shift it to whichever sources of liquidity offer the best execution.

## **Opportunities and Challenges**

Global investment strategies offer both rewards and risks. Experienced global managers, however, can take many of these risks and turn them into opportunities. Truly global managers understand the relationships and drivers of today's markets, sectors and securities, and develop a process that efficiently capitalizes on opportunities by assessing them against a broad range of peers.

Not doing so means missing out on what the world has to offer.



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