Deutsche Bank

8 August 2011

Quantitative Strategy

Global Markets Research

QCD Stock Selection

QCD model update

Research summary
Every month, we provide our readers with a review of broad quant factor performance, our QCD model recommendations, and our model performance. Please contact us to be added to our spreadsheet distribution list.

August 2011 update

Broad quantitative alpha factor performance
Last month was a mixed bag in terms of factor performance. The clearest winners were quality factors, as investors repositioned their portfolios towards safety as risk aversion began to climb again.

Model recommendations
For August 2011, our model suggests allocating more weight to value, growth, momentum, revision, and quality factors,, and less weight to technical factors.

In the large cap space, i.e., Russell 1000 index, our model suggests overweighting the healthcare and consumer staples sectors; and underweighting the financials and consumer discretionary sectors.

Within small-cap universe, i.e., Russell 2000 index, our model suggests materials and utilities are likely to outperform, while the financials and the consumer discretionary sectors are likely to underperform.

The QCD model performance
Last month, our QCD model outperformed with a sector-neutral rank information coefficient (IC) of 2%.

Our five model portfolio performance
Last month, the five model portfolios (large-cap core, large-cap value, large-cap growth, small-cap, and market neutral) produced after-cost active returns of 0.03%, -0.12%, -0.35%, 1.55%, and -0.47%, respectively.

An in-depth description of our model methodology can be found in our *DB Quant Handbook*, July 22, 2010. QCD model scores for all stocks in our universe and the exact holdings in our five model portfolios are available in two separate spreadsheets. Please contact us to be added to the spreadsheet distribution list.

Please note that all our research is distributed from DBEQS.Americas@db.com. A list of our recent publications can be found in the Appendix.

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Factor performance review

Every month, we review the performance of about 80 factors from our factor library (Figure 1). Please note that this is only a small fraction of our factor library, which includes over 1,200 factors for the US market. We choose these 80 factors to provide a balanced view for each broad factor category – they are not necessarily the best 80 factors or the factors in our QCD model.

We measure factor performance in five standard analyses: long/short hedged portfolio, Pearson information coefficient, Spearman rank IC, sector-neutral IC, and risk-adjusted IC. For simplicity, we present only Spearman rank IC in this report.

Due to space limitation, we will present the results for only the broad investable universe, i.e., the union of Russell 3000, S&P 1500, and MSCI USA indices. We perform standard factor backtesting for more sub-universes on a daily basis, e.g., all major Russell and S&P index families, GICS sectors/industry groups, etc. Please contact us for customized factor backtesting.

Last month was a mixed bag in terms of factor performance. The clearest winners were quality factors, as investors repositioned their portfolios towards safety as risk aversion began to climb again.

Figure 1: Broad factor performance review, Spearman rank IC

Factor Name	Direction[1]	Current # of Stocks	Average (%) Last M	12M Avg	3Y Avg	Since Inception Avg	Std Dev	Max	Min	p-value[2]	# of Months	Avg # of Stocks	%Positive	Avg in Up Mkt (%)	Avg in Dn Mkt (%)	Serial Corr (%)[3]
1. Value																
1 Dividend yield, trailing 12M	Ascending	2,973	9.42	(1.33)	0.81	2.65	14.76	42.92	(32.80)	0.00	283	2,813	54.77	(2.62)	11.86	99.29
2 Expected dividend yield	Ascending	2,973	10.26	(0.87)	0.93	2.89	15.09	43.91	(33.31)	0.00	283	2,813	54.06	(2.58)	12.47	99.30
3 Price-to-operating EPS, trailing 12M, Basic	Descending	2,340	(7.50)	(0.84)	1.75	2.91	10.78	30.95	(31.06)	0.00	198	2,376	59.09	0.93	6.37	95.12
4 Operating earnings yield, trailing 12M, Basic	Ascending	2,953	(1.75)	2.60	2.50	4.71	13.50	46.11	(33.51)	0.00	198	2,884	60.61	(0.29)	13.46	96.20
5 Earnings yield, forecast FY1 mean	Ascending	2,795	(3.04)	2.81	1.64	4.38	12.53	47.77	(34.46)	0.00	283	2,529	62.90	0.93	10.41	94.98
6 Earnings yield, forecast FY2 mean	Ascending	2,790	(2.87)	2.48	2.18	3.99	12.03	45.95	(33.92)	0.00	283	2,425	63.60	1.74	7.93	94.22
7 Earnings yield x IBES 5Y growth	Ascending	1,826	(9.40)	1.62	1.39	1.84	10.33	41.21	(27.88)	0.01	198	1,966	60.61	4.15	(2.22)	93.47
8 Sector-rel Operating earnings yield, trailing 12M, Basic	Ascending	2,953	(2.72)	3.06	2.51	4.03	8.59	28.32	(15.77)	0.00	198	2,884	66.67	1.16	9.05	95.72
9 Hist-rel Operating earnings yield, trailing 12M, Basic	Ascending	2,628	(7.43)	(0.57)	0.11	0.72	7.01	17.07	(17.53)	0.19	163	2,500	52.15	0.47	1.10	93.30
10 Operating cash flow yield (income stmt def)	Ascending	2,955	0.31	3.22	1.99	4.09	11.34	46.10	(32.95)	0.00	283	2,767	65.02	0.98	9.51	95.69
11 Cash flow yield, FY1 mean	Ascending	1,614	4.37	2.14	1.42	1.70	13.62	35.60	(48.02)	0.07	205	868	57.07	1.01	2.94	96.32
12 Free cash flow yield	Ascending	2,908	0.24	1.37	2.37	4.84	8.17	32.78	(19.42)	0.00	246	2,521	73.58	2.44	9.14	94.44
13 Price-to-sales, trailing 12M	Descending	2,919	(6.99)	(0.01)	2.41	1.99	11.09	40.35	(29.56)	0.00	283	2,745	56.89	1.70	2.50	99.06
14 Price-to-book	Descending	2,865	2.38	(3.68)	0.54	1.00	10.94	34.65	(25.64)	0.12	283	2,728	50.53	(0.14)	3.00	97.48
15 EBITDA/EV	Ascending	2,609	3.62	3.08	1.68	4.15	10.44	40.18	(27.79)	0.00	283	2,429	65.37	1.22	9.27	95.18
16 Price-to-book adj for ROE, sector adj	Descending	2,704	(5.54)	(2.09)	1.04	0.64	8.80	32.65	(21.81)	0.23	283	2,453	50.18	1.04	(0.07)	95.31
2. Growth																
17 Hist 5Y operating EPS growth	Descending	2,835	(4.14)	2.76	0.45	0.64	7.49	20.16	(20.78)	0.24	191	2,650	53.40	(1.12)	3.55	97.11
18 Hist 5Y operating EPS acceleration	Ascending	2,835	(2.51)	(2.18)	(1.91)	0.98	6.28	14.08	(17.05)	0.03	191	2,650	58.64	0.19	2.28	94.31
19 IBES 5Y EPS growth	Ascending	1,901	(2.37)	3.97	0.50	0.68	8.85	23.00	(30.49)	0.20	283	1,884	54.06	1.97	(1.58)	98.22
20 IBES 5Y EPS growth/stability	Ascending	1,901	(3.10)	3.88	0.86	1.15	8.12	21.97	(21.21)	0.02	283	1,884	55.48	0.97	1.46	98.59
21 IBES LTG EPS mean	Descending	2,138	3.82	(3.61)	(0.69)	1.79	16.27	52.30	(37.37)	0.06	283	2,157	48.76	(3.85)	11.65	97.98
22 IBES FY2 mean DPS growth	Ascending	2,057	2.55	(0.52)	0.48	0.64	8.47	23.79	(20.93)	0.43	110	1,399	51.82	(3.03)	7.06	87.93
23 IBES FY1 mean EPS growth	Ascending	2,097	(2.66)	1.54	(2.00)	0.77	8.38	21.40	(29.20)	0.12	283	2,140	59.01	2.19	(1.72)	88.71
24 Year-over-year quarterly EPS growth	Ascending	2,949	(1.64)	3.39	(0.29)	2.33	7.15	24.40	(21.05)	0.00	198	2,893	67.68	2.29	2.40	81.15
25 IBES FY1 mean CFPS growth	Descending	1,489	(1.10)	(1.22)	2.20	0.17	10.76	41.86	(26.89)	0.85	155	559	50.97	(0.36)	1.10	92.47
26 IBES SUE, amortized	Ascending	2,511	(1.27)	2.03	(0.44)	1.30	6.22	20.01	(15.76)	0.00	221	2,283	59.73	2.00	0.10	73.39
3. Price momentum and reversal																
27 Total return, 1D	Descending	2,972	4.90	3.67	3.17	5.07	7.10	34.06	(15.49)	0.00	283	2,769	78.80	5.05	5.09	1.68
28 Total return, 21D (1M)	Descending	2,972	(5.74)	1.02	0.82	2.11	10.76	41.84	(27.50)	0.00	283	2,769	59.36	3.84	(0.90)	0.18
29 Maximum daily return in last 1M (lottery factor)	Descending	2,971	5.58	1.47	1.92	4.92	14.93	55.32	(38.37)	0.00	283	2,646	63.96	(1.13)	15.49	51.94
30 21D volatility of volume/price	Descending	2,971	0.20	1.97	1.09	0.36	6.91	17.88	(24.64)	0.38	283	2,646	50.88	1.18	(1.07)	55.64
31 Total return, 252D (12M)	Ascending	2,872	1.31	2.93	(2.32)	2.82	14.05	38.82	(55.90)	0.00	283	2,690	61.48	1.31	5.45	89.08
32 12M-1M total return	Ascending	2,872	0.10	3.39	(1.54)	3.71	13.22	37.32	(48.47)	0.00	283	2,690	65.02	2.75	5.39	87.63
33 Price-to-52 week high	Ascending	2,902	13.28	2.79	(1.97)	3.08	16.44	48.47	(58.28)	0.00	283	2,706	62.54	(2.44)	12.73	82.72
34 Total return, 1260D (60M)	Ascending	2,467	5.64	4.88	(1.16)	0.82	10.74	23.93	(34.21)	0.21	271	2,135	55.35	0.27	1.77	97.18
4. Sentiment																
35 IBES LTG Mean EPS Revision, 3M	Ascending	1,977	2.11	0.66	(0.49)	0.84	3.90	12.24	(12.34)	0.00	283	2,080	61.48	0.62	1.21	59.20
36 IBES FY1 Mean EPS Revision, 3M	Ascending	2,731	5.22	2.16	(0.60)	2.84	8.61	26.35	(32.95)	0.00	283	2,467	66.08	2.51	3.40	76.06
37 IBES FY1 EPS up/down ratio, 3M	Ascending	2,727	2.90	2.46	0.01	3.09	7.95	24.00	(24.67)	0.00	283	2,326	65.72	3.38	2.58	79.64
38 Expectation gap, short-term - long-term	Ascending	2,097	(2.95)	1.20	(1.47)	1.25	5.14	15.55	(22.92)	0.00	283	2,138	65.72	1.32	1.13	87.29
39 IBES FY1 Mean CFPS Revision, 3M	Ascending	1,452	5.65	1.92	(0.67)	0.87	10.31	29.49	(37.12)	0.24	197	800	61.93	(0.10)	2.56	65.19
40 IBES FY1 Mean SAL Revision, 3M	Ascending	2,713	4.50	2.40	(0.21)	1.08	7.92	27.89	(24.31)	0.07	181	2,138	60.22	0.61	1.82	71.31
41 IBES FY1 Mean FFO Revision, 3M	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
42 IBES FY1 Mean DPS Revision, 3M	Ascending	1,127	2.97	2.87	0.36	0.57	5.38	15.47	(16.80)	0.28	107	970	57.94	0.34	0.97	61.42
43 IBES FY1 Mean ROE Revision, 3M	Ascending	2,048	(0.26)	1.89	0.24	0.73	6.76	21.19	(21.55)	0.27	107	1,690	58.88	0.06	1.94	66.22
44 Recommendation, mean	Descending	2,138	(0.90)	4.84	0.75	0.88	8.38	21.84	(23.50)	0.13	212	2,275	56.60	2.63	(2.20)	94.26
45 Mean recommendation revision, 3M	Descending	1,981	0.59	0.43	0.47	1.32	4.26	11.94	(19.67)	0.00	209	2,197	64.11	1.19	1.55	60.04
46 Target price implied return	Ascending	2,129	(7.57)	3.02	3.05	1.01	16.43	61.59	(38.29)	0.46	148	2,093	54.73	8.79	(10.10)	78.33
47 Mean target price revision, 3M	Ascending	1,970	3.38	0.58	(1.25)	1.91	13.60	30.54	(43.72)	0.09	145	2,003	62.07	(0.59)	5.45	75.60
5. Quality																
48 ROE, trailing 12M	Ascending	2,851	(2.29)	4.29	2.17	4.10	11.16	35.70	(31.83)	0.00	198	2,813	63.64	0.28	10.79	97.90
49 Return on invested capital (ROIC)	Ascending	2,941	(1.85)	4.51	2.43	3.95	10.19	31.79	(29.65)	0.00	198	2,875	64.14	0.54	9.92	98.09
50 Sales to total assets (asset turnover)	Ascending	2,956	(7.86)	4.69	3.57	1.61	8.93	22.90	(22.20)	0.00	283	2,765	57.60	2.50	0.07	99.43
51 Operating profit margin	Ascending	2,903	1.73	1.34	1.02	1.09	5.36	16.03	(14.20)	0.00	283	2,600	60.07	0.69	1.80	98.43
52 Current ratio	Descending	2,355	2.13	(0.02)	(0.07)	1.93	10.53	38.59	(31.29)	0.00	283	2,229	54.77	(0.99)	7.02	97.85
53 Long-term debt/equity	Ascending	2,830	4.16	(0.08)	(0.01)	0.65	9.73	35.17	(27.71)	0.26	283	2,705	47.35	(1.24)	3.94	98.48
54 Altman's z-score	Ascending	2,330	3.01	1.80	0.53	0.04	9.35	31.81	(30.14)	0.95	283	2,159	49.47	0.71	(1.14)	98.21
55 Merton's distance to default	Ascending	2,179	1.40	3.60	1.11	3.01	11.50	30.27	(42.82)	0.00	283	2,125	65.37	(0.83)	9.73	94.73
56 Ohlson default model	Descending	2,298	2.41	2.76	0.98	2.07	6.19	18.39	(15.67)	0.00	246	2,108	65.85	1.47	3.15	98.09
57 Campbell, Hilscher, and Szilagyi model	Descending	2,611	(0.25)	4.44	1.12	2.49	11.75	26.12	(36.73)	0.00	199	2,535	56.78	(1.13)	8.86	97.00
58 Accruals (Sloan 1996 def)	Descending	1,778	4.49	(0.04)	(0.02)	0.61	4.37	13.91	(11.24)	0.02	283	1,405	56.89	0.66	0.52	89.07
59 Firm-specific discretionary accruals	Descending	1,660	1.99	0.95	0.73	0.51	4.20	13.60	(11.75)	0.09	190	1,350	50.53	0.06	1.25	98.52
60 Hist 5Y operating EPS stability, coef of determination	Ascending	2,835	(1.41)	0.06	(0.98)	0.51	4.93	13.29	(12.22)	0.16	191	2,650	52.88	0.32	0.81	96.62
61 IBES 5Y EPS stability	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
62 IBES FY1 EPS dispersion	Descending	2,610	0.83	5.07	1.58	2.28	10.32	25.50	(35.89)	0.00	283	2,308	61.13	(0.60)	7.31	84.82
63 Payout on trailing operating EPS	Ascending	2,262	10.84	(2.99)	(0.45)	0.63	13.73	38.96	(30.80)	0.44	283	2,197	50.18	(4.22)	9.11	99.22
64 YoY change in # of shares outstanding	Descending	2,906	4.63	2.01	2.09	2.54	8.99	45.66	(18.80)	0.00	283	2,715	58.66	(0.87)	8.50	93.86
65 YoY change in debt outstanding	Descending	2,209	0.30	(1.02)	(0.35)	0.31	4.10	10.47	(12.60)	0.20	283	2,173	56.18	1.03	(0.95)	89.68
66 Net external financing/net operating assets	Ascending	2,897	5.84	1.16	1.67	2.82	10.22	47.77	(27.56)	0.00	283	2,461	57.95	(0.31)	8.29	94.72
67 Piotroski's F-score	Ascending	2,206	2.36	2.15	(0.46)	3.00	11.00	36.04	(30.75)	0.00	198	2,150	59.60	(1.24)	10.42	90.35
68 Mohanram's G-score	Ascending	587	3.85	2.00	1.55	2.04	8.76	23.29	(28.58)	0.00	198	448	57.58	(0.06)	5.72	94.86
6. Technicals																
69 # of days to cover short	Descending	2,974	(4.22)	3.19	1.68	2.56	9.54	25.27	(33.83)	0.01	100	2,891	55.00	3.37	0.98	93.08
70 CAPM beta, 5Y monthly	Descending	2,661	10.22	(1.44)	(2.05)	0.81	17.13	47.46	(46.59)	0.48	223	2,278	47.09	(7.41)	15.21	98.68
71 CAPM idosyncratic vol, 1Y daily	Descending	2,898	7.85	2.93	1.98	4.67	17.88	57.92	(39.71)	0.00	283	2,663	60.78	(2.00)	16.33	99.14
72 Realized vol, 1Y daily	Descending	2,898	8.71	2.29	1.46	4.57	18.51	59.23	(40.14)	0.00	283	2,663	60.07	(2.69)	17.25	99.07
73 Skewness, 1Y daily	Descending	2,898	(0.70)	0.46	0.24	1.11	5.40	20.19	(14.38)	0.00	283	2,663	56.54	0.55	2.10	89.57
74 Kurtosis, 1Y daily	Descending	2,898	9.71	1.53	0.73	1.33	5.69	16.79	(15.27)	0.00	283	2,663	62.19	0.92	2.04	91.24
75 Idiosyncratic vol surprise	Descending	2,747	0.86	3.99	1.76	2.76	7.45	26.30	(26.53)	0.00	282	2,650	66.31	0.90	5.99	86.55
76 Normalized abnormal volume	Ascending	2,973	1.96	2.56	1.57	1.05	6.87	20.03	(20.63)	0.01	283	2,806	59.01	2.45	(1.41)	81.55
77 Float turnover, 12M	Descending	2,974	8.52	(0.68)	(1.11)	2.04	15.97	55.05	(36.72)	0.03	283	2,817	50.18	(5.00)	14.34	99.19
78 Moving average crossover, 15W-36W	Ascending	2,861	4.78	(0.78)	(2.01)	2.03	13.23	44.24	(52.53)	0.01	283	2,397	59.01	0.67	4.41	90.75
79 Log float-adj capitalization	Ascending	2,973	(0.89)	4.14	2.02	2.95	10.92	26.56	(38.42)	0.00	283	2,813	60.78	2.55	3.64	99.35
80 # of month in the database	Ascending	2,974	0.97	0.48	1.42	2.17	8.19	35.34	(21.02)	0.00	258	2,817	58.91	(0.35)	6.55	88.41
81 DB composite options factor	Ascending	1,452	2.96	2.25	1.39	1.93	4.69	14.68	(18.88)	0.00	120	1,466	68.33	0.91	3.57	2.29

Note

1 Direction indicates how the factor scores are sorted. Ascending order means higher factor scores are likely to be associated with higher subsequent stock returns, and vice versa for descending order.

2 P-value indicates the statistical significance of a factor's performance. A smaller p-value suggests that it is more likely the factor's performance is different from zero.

3 This is the autocorrelation of a factor's scores over time. Higher serial correlation is likely to have lower portfolio turnover based on the factor.

Source: Compustat, Bloomberg Finance LP, IBES, Russell, S&P, Thomson Reuters, and Deutsche Bank

Model recommendations

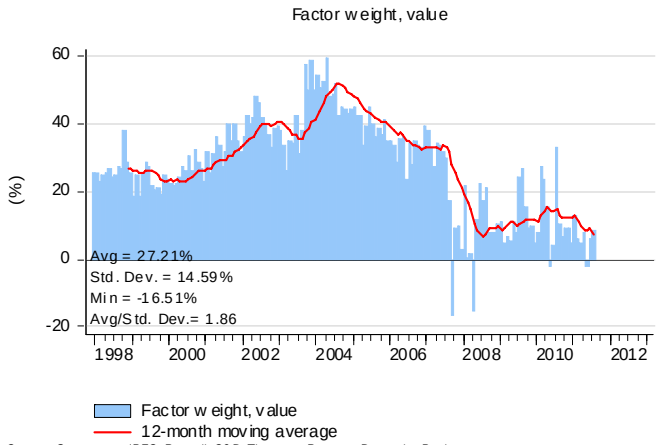
Our QCD model is primarily designed as a stock-selection tool. However, as a side benefit, it also gives us style and sector views.

Style outlook

Figure 2 to Figure 7 show the weightings of the six style factors in our QCD model. Please note that this is based on our style rotation model, i.e., our predicted factor performance for the six style factors.

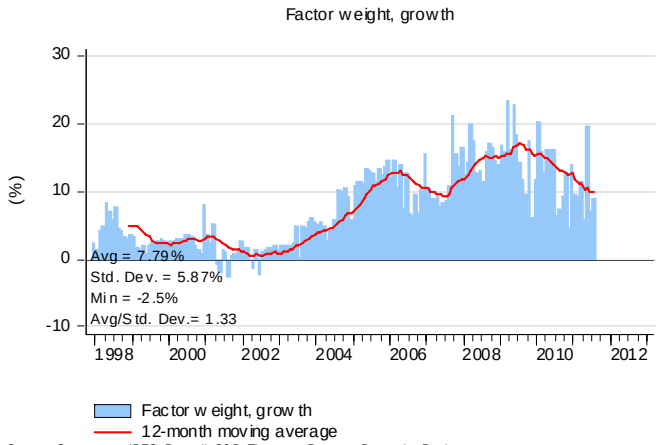
For August 2011, our model suggests allocating more weight to value, growth, momentum, revision, and quality factors,, and less weight to technical factors.

Figure 2: Factor weight, value



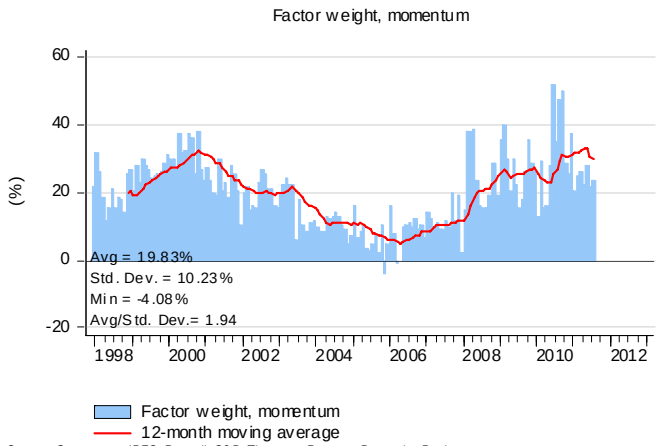
Source: Compustat, IBES, Russell, S&P, Thomson Reuters, Deutsche Bank

Figure 3: Factor weight, growth



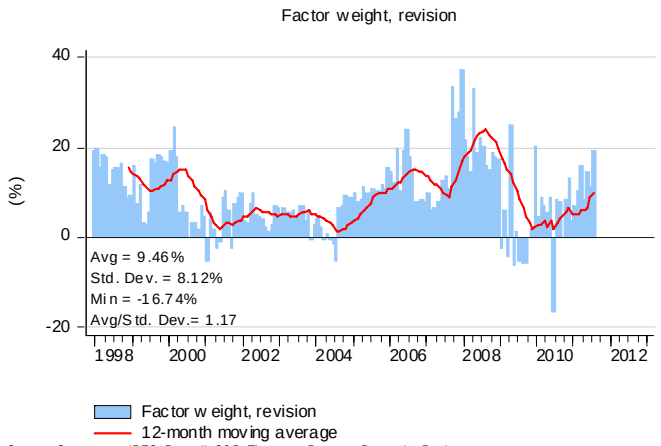
Source: Compustat, IBES, Russell, S&P, Thomson Reuters, Deutsche Bank

Figure 4: Factor weight, momentum/reversal



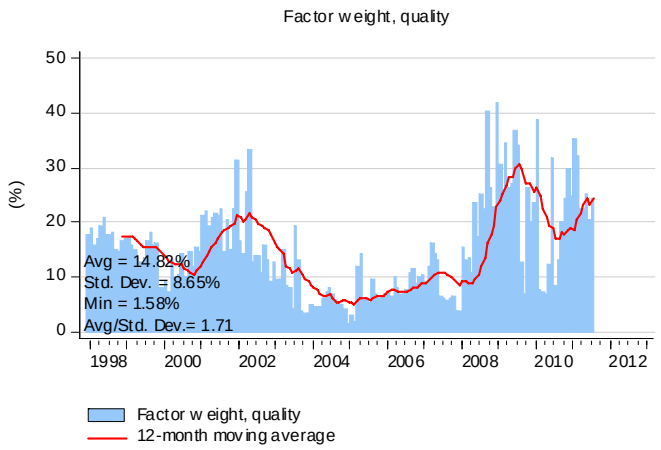
Source: Compustat, IBES, Russell, S&P, Thomson Reuters, Deutsche Bank

Figure 5: Factor weight, sentiment



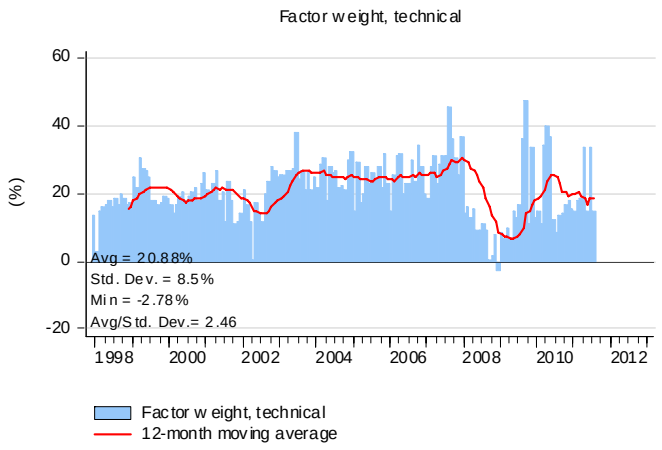
Source: Compustat, IBES, Russell, S&P, Thomson Reuters, Deutsche Bank

Figure 6: Factor weight, quality



Source: Compustat, IBES, Russell, S&P, Thomson Reuters, Deutsche Bank

Figure 7: Factor weight, technical

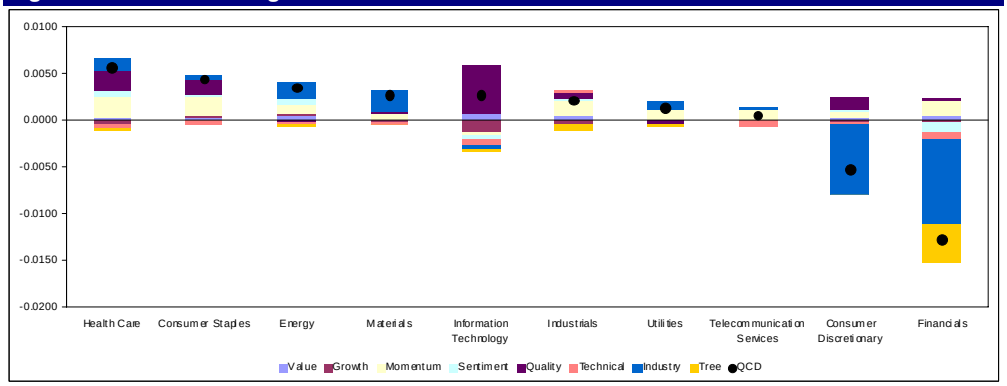


Source: Compustat, IBES, Russell, S&P, Thomson Reuters, Deutsche Bank

Sector outlook

In the large cap space, i.e., Russell 1000 index, our model suggests overweighting the healthcare and consumer staples sectors; and underweighting the financials and consumer discretionary sectors (Figure 8).

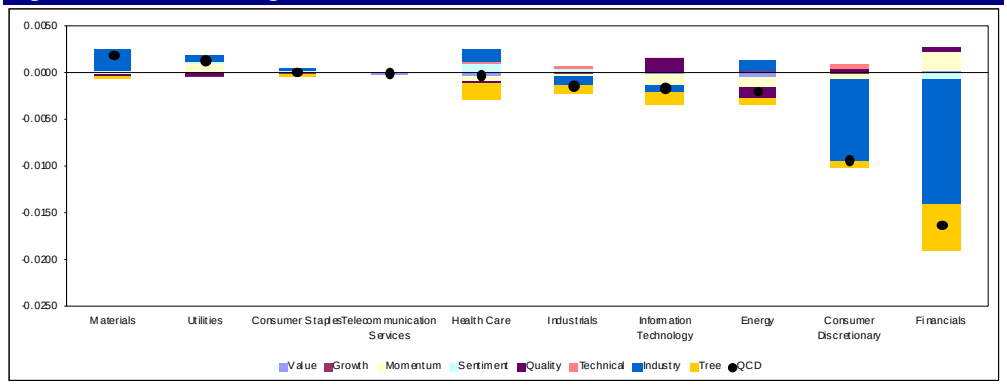
Figure 8: Sector ranking – Russell 1000 universe



Source: Compustat, IBES, Russell, S&P, Thomson Reuters, and Deutsche Bank

Within small-cap universe, i.e., Russell 2000 index, our model suggests materials and utilities are likely to outperform, while the financials and the consumer discretionary sectors are likely to underperform (Figure 9).

Figure 9: Sector ranking – Russell 2000 universe



Source: Compustat, IBES, Russell, S&P, Thomson Reuters, and Deutsche Bank

Stock recommendations

Due to space limitation, we do not present detailed stock rankings in the report. Detailed rankings are available in our monthly spreadsheet. Please contact us to be added to the spreadsheet distribution list.

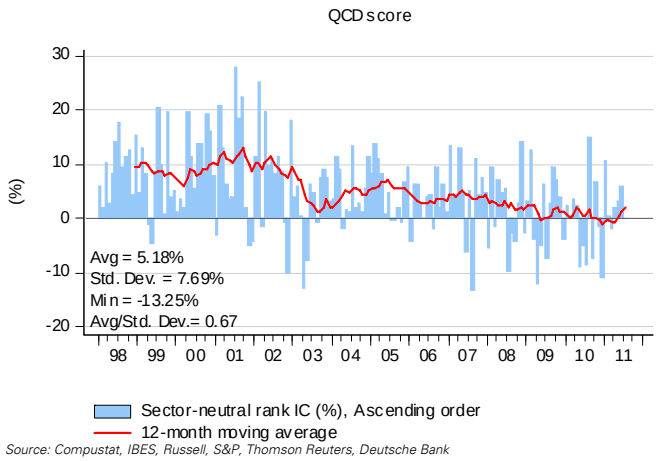
QCD model performance review

Since December 1997, the QCD model has performed well. The most challenging periods for the QCD model were in late 2003/early 2004 and 2009/early 2010. We have seen some recovery in recent months (Figure 10). We recommend using the QCD model in a sector-neutral context, as the model has stronger skill in selecting stocks than ranking sectors (Figure 10 vs. Figure 11).

Last month, our model outperformed with a sector-neutral rank information coefficient (IC) of 2%.

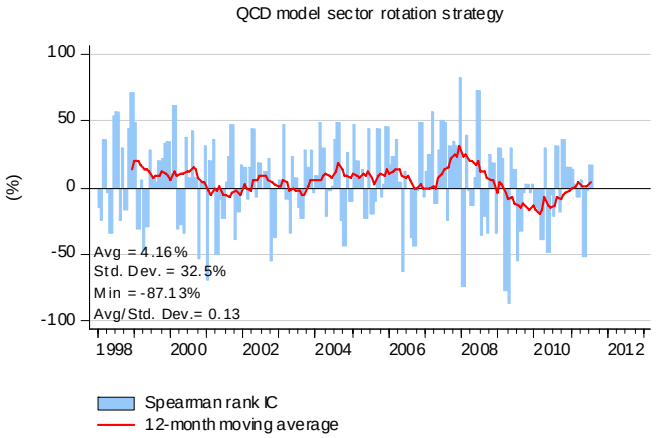
A more useful and realistic performance measurement is done at the portfolio level. We have five model portfolios: long-only large-cap core, long-only large-cap value, long-only large-cap growth, long-only small-cap, and long/short market neutral with typical institutional constraints and transaction costs. The IR/Sharpe ratio for the five model portfolios ranges from 1.5 to 3.2 and stays positive almost every year since 1998. Even in 2008 and 2009, two of the most challenging years for quantitative investing, our market-neutral strategy produces Sharpe ratio of 0.82 and 1.64, respectively.

Figure 10: Sector-neutral rank IC



Source: Compustat, IBES, Russell, S&P, Thomson Reuters, Deutsche Bank

Figure 11: Rank IC – industry rotation



Source: Compustat, IBES, Russell, S&P, Thomson Reuters, Deutsche Bank

Model portfolios

On a monthly basis, we build five standard model portfolios: 1) a long-only large-cap core portfolio benchmarked to the Russell 1000 index; 2) a long-only large-cap value portfolio benchmarked to the Russell 1000 Value index; 3) a long-only large-cap growth portfolio benchmarked to the Russell 1000 Growth index; 4) a long-only small-cap portfolio benchmarked to the Russell 2000 index; and 5) a long/short market neutral portfolio. We can also create customized portfolios for clients, e.g., large-cap value portfolio, large-cap growth portfolio, 130/30 portfolios. Please contact us for details.

The IR/Sharpe ratio for the five model portfolios ranges from 1.5 to 3.2 and stays positive almost every year since 1998. Even in 2008 and 2009, two of the most challenging years for quantitative investing, our market-neutral strategy produces Sharpe ratio of 0.82 and 1.64, respectively.

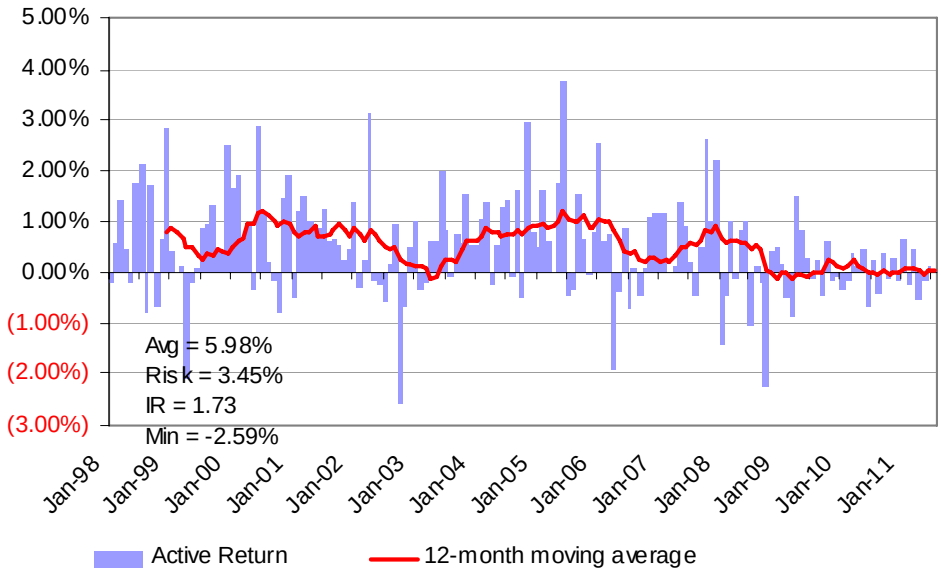
Last month, the five model portfolios produced active returns of 0.03%, -0.12%, -0.35%, 1.55%, and -0.47%, respectively.

Detailed holdings for the five model portfolios for next month are available in our monthly spreadsheet. Please contact us to be added to the spreadsheet distribution list.

Long-only large-cap core portfolio

For the long-only large-cap core portfolio, we try to maximize expected return with about 3.5% realized tracking error, using Russell 1000 as the benchmark. Figure 12 shows the portfolio performance vs. the benchmark.

Figure 12: Active return – long-only large-cap core portfolio

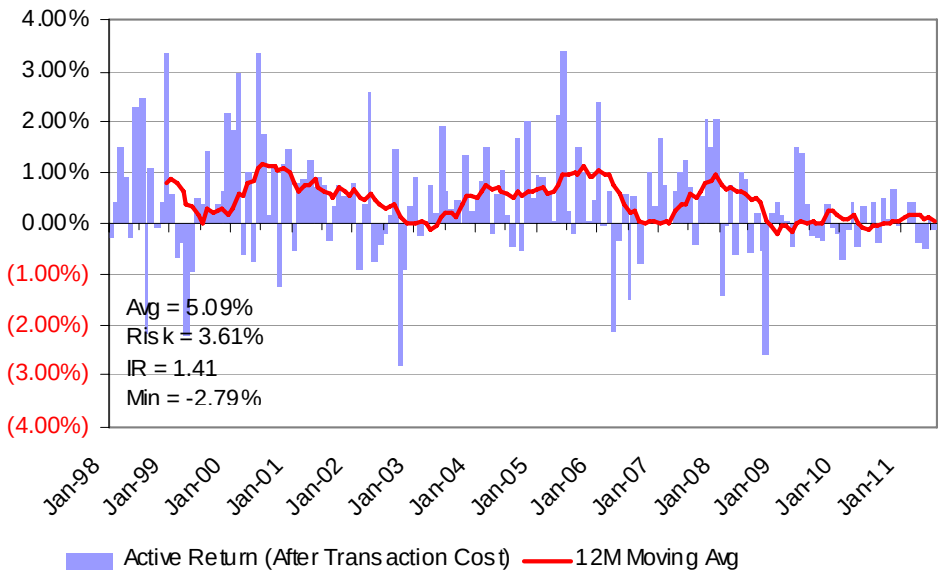


Source: Axioma, Compustat, IBES, Russell, S&P, Thomson Reuters, Deutsche Bank

Long-only large-cap value portfolio

For the long-only large-cap value portfolio, we try to maximize expected return with less than 4% realized tracking error, using Russell 1000 Value as the benchmark. Figure 13 shows the portfolio performance vs. the benchmark.

Figure 13: Active return – long-only large-cap value

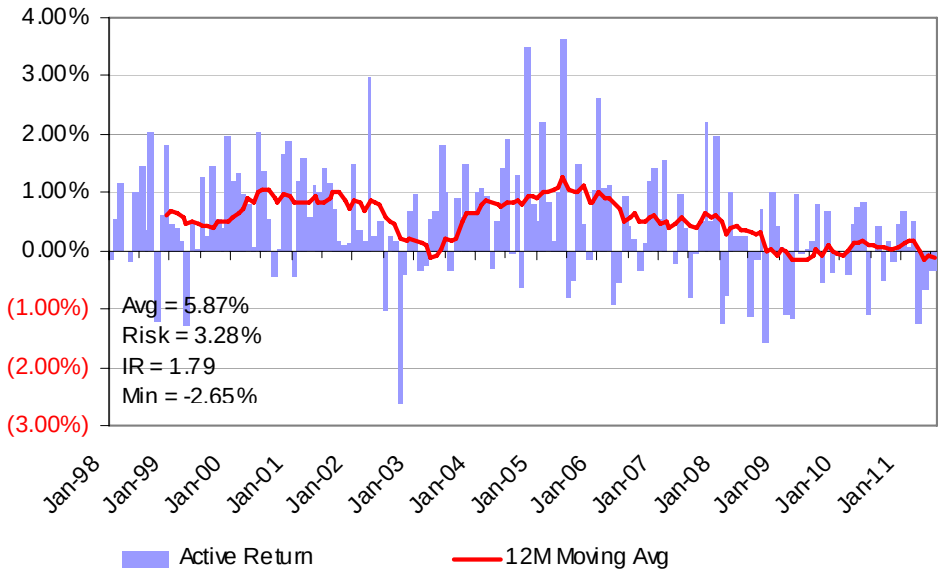


Source: Axioma, Compustat, IBES, Russell, S&P, Thomson Reuters, Deutsche Bank

Long-only large-cap growth portfolio

For the long-only large-cap growth portfolio, we try to maximize expected return with about 3% realized tracking error, using Russell 3000 Growth as the benchmark. Figure 14 shows the portfolio performance vs. the benchmark.

Figure 14: Active return – long-only large-cap growth portfolio

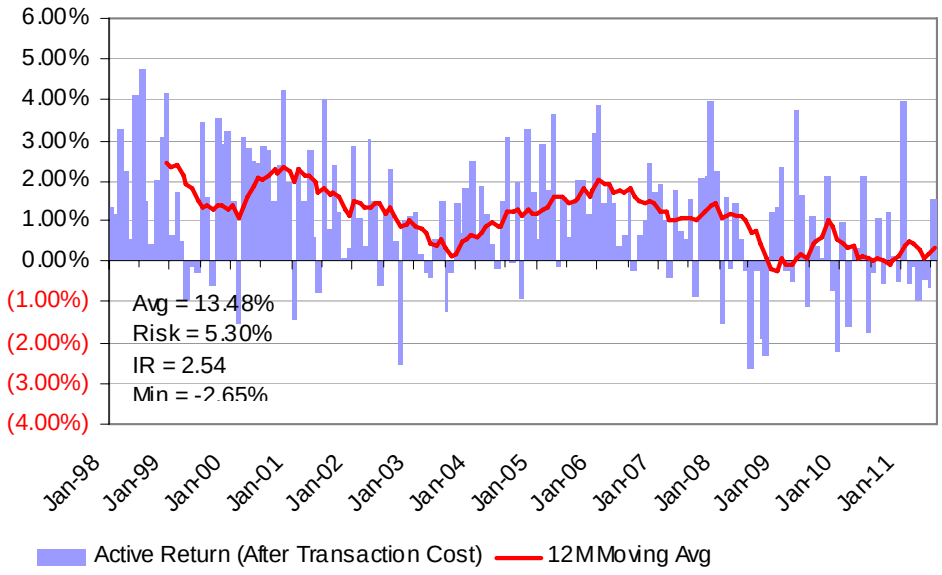


Source: Axioma, Compustat, IBES, Russell, S&P, Thomson Reuters, Deutsche Bank

Long-only small-cap portfolio

For the small-cap long-only portfolio, we try to maximize expected return with about 5% realized tracking error, using Russell 2000 as the benchmark. Figure 15 shows the portfolio performance vs. the benchmark.

Figure 15: Active return – long-only small-cap portfolio

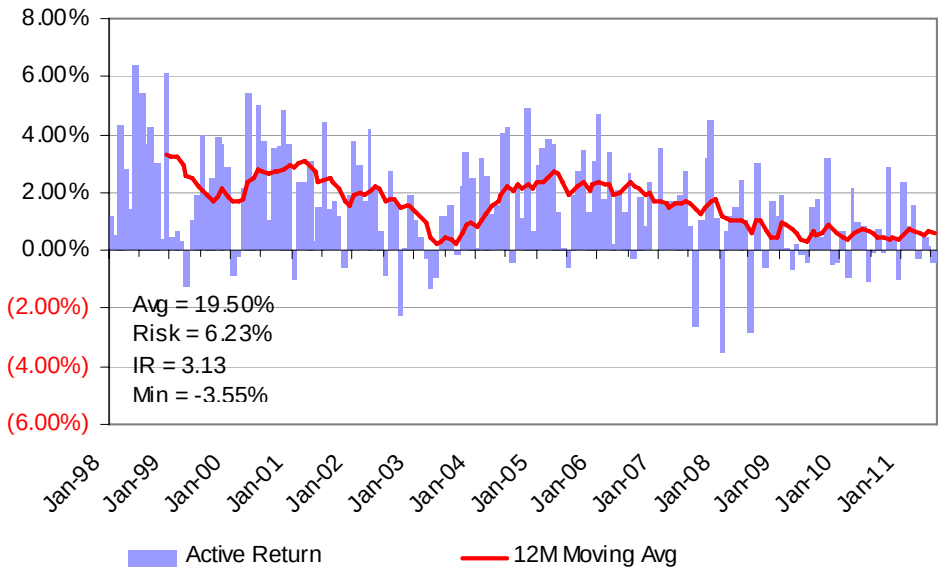


Source: Axioma, Compustat, IBES, Russell, S&P, Thomson Reuters, Deutsche Bank

Long/short market-neutral portfolio

For the long/short market neutral portfolio, we try to maximize expected return with about 6% realized volatility. Figure 16 shows the portfolio performance.

Figure 16: Active return – long/short marketing neutral portfolio



Source: Axioma, Compustat, IBES, Russell, S&P, Thomson Reuters, Deutsche Bank

Please note that with each of the model portfolios, past performance is no guarantee of future results. Calculations include transaction costs. Additional information is available on request.

Appendix – Deutsche Bank US/Global Quant Research Library

Deutsche Bank's US/Global quantitative strategy team produces one monthly newsletter, *Quantum*, and six regular research series: 1) *Signal Processing* on stock-selection factors/signals; 2) *Portfolios Under Construction* on risk and portfolio construction; 3) *Emerging Issues* on topical and emerging issues; 4) *QCD Model* on stock-selection models; 5) *Academic Insights* on academic research; and 6) *Canada Quant* on topics unique to the Canadian equity market.

All our research is distributed from DBEQS.Americas@db.com. Please contact us to be added to our research distribution list.

Quantum

Quantum is our monthly newsletter. The aim of Quantum is to make it easier for clients to keep track of all the research we publish, and to serve as a forum to highlight the latest news and thinking in the quant investing world. If you only read one email from us every month, make it *Quantum*.

- **Quantum** (July 30, 2011)
- **Quantum** (June 29, 2011)
- **Quantum** (May 20, 2011)
- **Quantum** (April 29, 2011)
- **Quantum** (March 31, 2011)
- **Quantum** (February 28, 2011)
- **Quantum** (January 27, 2011)
- **Quantum** (November 29, 2010)
- **Quantum** (October 28, 2010)
- **Quantum** (September 20, 2010)

Signal Processing

This is our flagship monthly alpha signal research series. We try to identify new data sources, build new and innovative factors, and investigate various style rotation models.

- **Reviving Momentum: Mission Impossible?** (July 6, 2011). In this report, we analyze the link between Beta and Momentum factor performance. We find that Beta it is a major driver of risk and performance for Momentum strategies over time. In fact, Beta played a significant role in the drawdown experienced by the momentum factor during the "junk" rally in 2009. We find that controlling Beta risk in the right way can lessen drawdown and improve overall risk-adjusted performance.
- **Do Bonds Know Better?** (May 4, 2011). In this report, we show that fixed income data is useful for quantitative equity investors. We use a unique Deutsche Bank database of

corporate bonds – the DBIQ database – to analyze whether fixed income metrics have predictive power for future stock returns. We find that certain signals from the bond market do lead the equity market and as such can offer a new alpha source, even for those who can only trade equities.

- **A Quant Handbook on REIT Investing** (May 2, 2011). We find REITs stocks behave differently from non-REIT stocks. We test both traditional factors, but also a new data source – SNL, the de facto standard on REIT industry data. We find performance can be significantly improved by incorporating REIT-specific factors. In fact, our QCD-REIT model has outperformed our generic QCD model, by boosting portfolio IR by 81% in the past 11 years and 240% in the past three years.
- **Oil Shock: A Quant Perspective** (March 25, 2011). Once again the price of oil is caught up in a nexus of political and economic uncertainty. In this report we develop a better way to measure a stock's sensitivity to oil price movements. The enhanced oil beta that we develop is less backwards-looking than the traditional regression beta, and does a better job at capturing future oil price sensitivity.
- **The Long and the Short of It** (January 18, 2011). We use the DataExplorers securities lending database to develop new alpha signals based on stock lending and borrowing data. We show that we can combine these signals into a composite factor that works well in forecasting month-ahead stock returns. We also develop a way to adjust the factor scores for shorting costs, which helps steer the factor towards less costly names on the short side.
- **Frequency Arbitrage** (November 10, 2010). We try to bridge the gap between high and low frequency quant, and find that factors derived from high frequency data do have predictive power even for "traditional", lower-frequency quant investors.
- **Style Rotation** (September 7, 2010). We investigate three potential data sources to predict style factor performance: macroeconomic, capital market, and seasonal patterns. We find most academic research using economic variables in style timing suffers significant look-ahead bias. We test ten style prediction models, ranging from simple averages (assuming no style timing ability), linear regression, robust regression, Markov-switching, state-space, to nonlinear *TREE*, *FOREST*, and *PLANET* techniques. We find style rotation strategies can exhibit significant timing ability, which translates into better portfolio performance. Indeed, the multi-factor model built on style rotation strategies outperforms the naïve model (assuming no style rotation) by 54% in IR in the past 10 years. In the past three years, style rotation boosts IR by 1.30.
- **Beyond the Headlines** (July 19, 2010). In this research, we study text mining and natural language processing (NLP) in stock selection. We use three nonlinear model techniques (*TREE*, *FOREST*, and *PLANET*) to analyze news sentiment data and find signals can be used in both high and low frequency strategies.
- **Industry-Specific Factors** (June 7, 2010). Industry-specific data and factors like loan loss provision, same store sales growth, or break-even load factor have better predicative power than traditional/generic factors. We study 164 industry-specific factors in 12 industries. We found adding industry-specific factors to traditional multi-factor models can enhance model IC and portfolio IR.
- **The Options Issue** (May 12, 2010). We find options market tends to lead equity market. We find four signals from the options market have significant predictive power in forecasting month-ahead stock returns.
- **Launching US Quantitative Strategy** (April 12, 2010). We study three factors: 1) decomposing value factors – valuation ratios can be decomposed into a trend component (persistent) and cyclical component – both can be used to enhance value factor performance; 2) accruals and earnings quality – a small scaling adjustment can make a big difference; 3) market friction and price delay.

Portfolios Under Construction

In this series, we study various issues related to risk modeling and portfolio construction.

- **Tail Risk in Optimal Signal Weighting** (June 7, 2011). Traditional multi-factor stock selection models are built on mean-variance optimization without explicitly accounting for tail risk. Most common factors have negative skewness/excess kurtosis; therefore, most common multi-factor models also show greater tail risk than what's implied by a normal distribution. In this research, we demonstrate the benefit of incorporating tail risk in our optimal signal weighting decision process.
- **Learning to Drive in the Fast Lane** (April 26, 2011). This research analyzes and tests a new methodology that incorporates factor and portfolio dynamics into the optimal factor weighting decision. Specifically, we look at the efficacy of a new and simple technique that uses the underlying decay of each factor and the portfolio turnover policy to arrive at the optimal factor weighting decision. The framework and technique tells us how to find the optimal allocation to a fast decay signal when turnover constraints are stringent.
- **Minimum Variance: Exposing the "Magic"** (February 9, 2011). There are some nice properties for minimum variance portfolios, i.e., higher IR than the market portfolios, low turnover, and low correlation with traditional strategies. However, we find MVP is not necessarily a low-risk strategy. In the end, we propose a slight and simple enhancement to the strategy, which significantly improves MVP IR without increasing its risk. We also demonstrate that we can combine the MVP strategy with other active alpha models.
- **Robust Factor Models** (January 24, 2011). Traditionally, managers focus on selecting factors, while using the sample factor covariance matrix in constructing multifactor models. We compare the performance of the sample factor covariance matrix with 12 structured models (constant correlation, single index, four Bayesian shrinkage estimators, and six multivariate GARCH models). Our backtesting suggests that robust factor models incorporating structured covariance matrices improve portfolio IR significantly.
- **Correlation and Opportunity** (December 3, 2010). We find that stock return correlation has a long-term cyclical component that is linked to economic cycles. Negative economic sentiment is linked to increasing correlation.
- **Factor Neutralization and Beyond** (September 21, 2010). We expand our previous factor neutralization for the US market to Europe and find similar evidence. Many alpha factors have significant exposures to volatility. Neutralizing volatility exposure can improve factor consistency.
- **It's all in the Timing** (August 19, 2010). We examine, using "perfect foresight" simulations, whether style-timing actually adds value above and beyond the additional turnover costs incurred. We also use a real-world example, our QCD model, and find style timing is difficult, but not impossible.
- **Volatility = 1/N** (June 16, 2010). Many alpha factors have significant exposures to volatility. Neutralizing volatility exposure can improve factor consistency.
- **Quantiles versus Mean Variance** (April 23, 2010). Comparing quantile portfolios with mean-variance optimization. Two extreme cases of constructing a portfolio – quantiling or mean-variance optimization – can we learn something from both sides?

Emerging Issues

- **What's Hot in the World of Quant?** (April 12, 2011). Since we launched our research in April 2010, we have had the privilege of doing over 700 one-on-one meetings with quantitative investors around the world. In each of those meetings, we noted down the topics that you, the clients, requested we present on. This report aggregates that information into a unique set of statistics that tell an interesting story about what ideas are top of mind for buy-side quants rights now.

- **Global Macro–Quant Equity (GMQE) Model** (March 18, 2011). Even a temporary shock of a single economic variable is likely to affect other economic variables for a period of time. In this research, we build a VAR-based macroeconomic model to predict the shocks on the VIX index and oil price. From our economic forecasts, we further calculate the implied factor, industry, and stock performance. We call the bottom-up stock selection model with macro input, Global Macro–Quant Equity (GMQE) model.

- **Quant Crisis? What Crisis?** (January 28, 2011). We believe that sound quantitative research and investment should rest on in-depth and serious research rather than passive reaction to market speculation. We propose factor neutralization and robust factor modeling as two techniques dealing with sudden changes in risk regimes.

Academic Insights

On a monthly basis, we compile a list of practical academic papers related to investing. Every third month we also delve deeper into the most interesting ideas by carrying out our own backtesting and analysis.

- **Academic Insights** (July 21, 2011).
- **Academic Insights** (June 24, 2011).
- **Academic Insights** (May 27, 2011).
- **Academic Insights** (April 28, 2011).
- **Academic Insights** (March 29, 2011).
- **Academic Insights** (February 25, 2011).
- **Academic Insights** (January 20, 2011).
- **Academic Insights** (November 23, 2010).
- **Academic Insights** (October 27, 2010). *Backtesting edition* – We explore an interesting academic finding that momentum works better for high volatility stocks and reversal works better for low volatility stocks. We suggest four potential ways to exploit this relationship.
- **Academic Insights** (September 27, 2010)
- **Academic Insights** (August 23, 2010)
- **Academic Insights** (July 22, 2010). *Backtesting edition* – We confirm an academic finding that gross profitability over total assets is a better measure of profitability than traditional metrics like ROE and ROA. Furthermore, we show that this ratio is useful for conditioning value factors.
- **Academic Insights** (June 16, 2010)
- **Academic Insights** (May 20, 2010)
- **Academic Insights** (April 16, 2010). *Backtesting edition* – We show how a concept called the "capital gains overhang" can be used to exploit a behavioural bias and enhance the earnings surprise factor.
- **Academic Insights** (March 15, 2010)
- **Academic Insights** (February 12, 2010)

Canada Quant

On a monthly basis, we publish quant strategies unique to the Canadian equity market.

- **Technically Savvy Alpha** (May 6, 2011). In this report we show that quant factors derived from technical indicators have significant predict power in forecasting future stock returns. In particular, we find that quant factors derived from technical indicators have clearly outperformed conventional quantitative factors during the past three years, a period of unprecedented market volatility and uncertainty.
- **The Illusion of M&A and Asset Expansion** (February 14, 2011). In this research piece, we test whether M&A activity and other asset expansion transactions actually lead to a subsequent increase in stock returns. Contrary to the common belief, we find that companies that increase and expand their asset base actually have a tendency underperform.
- **New Options in Canada** (November 23, 2010). In this research, we expand a previous US quant research and find factors based on options data (put/call ratio, options implied volatility, skew, relative volume, and put-call parity) are useful in predicting stock returns in Canada.
- **Introducing Canada Quantitative Strategy** (October 24, 2010). Quant investing in Canada used to be easy – all you needed was price momentum and earnings revision. In the past three years, however, as more and more quant investors outside of Canada start to diversify into less crowded markets like Canada, the performance of traditional factors has dropped severely. In this research, we suggest two potential ways to add alpha in Canada in this challenging environment – identifying new and less crowded factors; and style rotation.

QCD Model

QCD is our flagship stock-selection model and illustrates our philosophy for picking stocks quantitatively. The model is updated every month, and is accompanied by an interactive spreadsheet.

- **DB Quant Handbook** (July 22, 2010). QCD is our main stock-selection model with a few unique features: factors are dynamically re-selected every month based on pre-determined algorithms; a nonlinear *TREE* model is combined with a linear panel data econometric model; and style rotation and industry timing models are incorporated in the bottom-up stock-selection model.
- **QCD Model Update** (July 6, 2011)
- **QCD Model Update** (June 6, 2011)
- **QCD Model Update** (May 6, 2011)
- **QCD Model Update** (April 7, 2011)
- **QCD Model Update** (March 9, 2011)
- **QCD Model Update** (February 7, 2011)
- **QCD Model Update** (January 6, 2011)
- **QCD Model Update** (December 6, 2010)
- **QCD Model Update** (November 2, 2010)
- **QCD Model Update** (October 6, 2010)
- **QCD Model Update** (September 8, 2010)
- **QCD Model Update** (August 6, 2010)

Appendix 1

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Additional information available upon request

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