The Big Interview: Chris Meredith

CHUCK JAFFE, MONEYLIFESHOW.COM — JANUARY 2018

Chuck Jaffe, Money Life Radio (MLR): Today we're going Big with Chris Meredith, Director of Research and Senior Portfolio Manager at O'Shaughnessy Asset Management. If the name rings a bell, it's because Jim O'Shaughnessy's been a guest on this show a number of times, and Jim O'Shaughnessy, of course, is the guy who wrote, What Works on Wall Street, and his firm uses research and some of the methods he described in his book, for the way it manages money. It also does it on a quantitative basis, and I'm really happy that we're talking with folks who look at the market on a quantitative basis, because that should make for some interesting discussions as we look ahead.

But if you want more information on the firm, go to OSAM.com for O'Shaughnessy Asset Management. If you want to learn more about Chris Meredith, and what he's doing, follow him on Twitter. He's @ChrisMeredith23. And, right now, he's on Money Life. Chris, welcome to the show.

Chris Meredith, CFA (Chris): Thanks, Chuck. Appreciate it.

MLR: So I said, "I am glad that I'm talking to somebody who kind of brings quantitative research to it," because, when I talk to a true quant, if I always say, "Hey, what's your favorite thing right now? What are you looking at, that you like the most?" Then, a true quant answers, "Well, I don't have a favorite. But my computer tells me: it's this," and we have been talking to a lot of folks that have a very positive outlook for the year ahead, but they don't necessarily have it backed up on the quantitative side. So, for you, when you're using the quantitative system, what is it telling you we should expect, going forward?

Chris: Well, listen, Chuck, thanks again for having me on, and like you said, it's important to note that we are factor investors, quantitative investors. So, we look at the market a little differently than some fundamental investors, and so, we have ways of pulling apart the universe of stocks, and selecting them, based on our investment themes.

Going forward for 2018, it's important to look back at 2017, and see what happened. We had a great year in 2017. Our flagship product outperformed by about 11%, the O'Shaughnessy Market Leaders Value. And what was interesting was that it did it in the face of a headwind, where value had been underperforming growth. And growth, by that, I mean "expensive stocks" that are out there. If you look at the difference between the Russell 1000 Growth, which was up 30.2%, versus the Russell 1000 Value, up 13.6, that's a gap of 16.5%.

So, while the overall market is up, cheap stocks have been underperforming, expensive stocks have been outperforming, and you've been seeing a lot of that coming through in areas like Technology. So, this part for us is (what we are excited about for the next year) is that this tends not to be a long-standing trend, where you see expensive stocks outperforming value stocks.

So, the fact that we've done well in an environment where it typically would be a headwind for quantitative investors is appealing for us. And that's where we get to feel like, eventually, at some point, there'll be a reversion. The value underperforming growth has been going on for a long time.

Now, ... we don't make calls on specific years. Like you said, we don't go through and say, "2018 is going to be, definitely a year where value outperforms growth." We take a long-term mindset. We believe that you invest in stocks — based on characteristics like value, momentum and yield — you'll outperform.

And then, 2018 for us is going to be where we have portfolios built for all weather conditions, whether it's a market downturn, or upturn. And, in particular, ones where you see those characteristics rewarded, which we feel is going to come around again.

MLR: That being the case, we are looking at fairly extraordinary times. You've got a market that, if it continues going up — for what, 8 months this year? — will be the longest Bull Market in history. How does that wind up affecting quantitative models?

Chris: Well, the part for us is, we specifically don't look at trying to time our factors. And you're right: The market's been going up a long time and this is the reason why we don't time it — because it is extraordinarily difficult to pick market tops. If you think about the number of times where people have said, over the past 3 years, that "This year will have a 20% correction inside of it, because the valuations are too high" ... There's one every year, and people have been proven wrong, as the market continues to go up.

Now, that said, with valuations where they are and, like you said, the long run, as Jim has said on your show in the past ... Is there a chance that you're going to see a correction — a 10%, 20% pullback? Yes. In fact, I would expect at some point, you're going to see one. But do we have confidence that, over the next five years, we're going to see markets higher than they are today? Yes.

The important thing, for us, is having a disciplined strategy where you're going through and building portfolios based on characteristics. We believe concentrated portfolios have the highest chance of outperformance. And sticking to those [concentrated portfolios] — particularly in the face of a market correction — you're going to see some pain points, if the market decides to have a pullback.

MLR: So, where are you thinking — since you are factor investors, where are the models telling you that you should be thinking — to overweight and underweight in 2018?

Chris: We're seeing certain areas overweighting and underweighting that are across our models, where, based on sectors, Energy is still an area, that it has some difficulties attached to it, across on yield, and momentum, in particular. But you are seeing some attractive areas inside a consumer, as well. But the important thing is that, for us, it's a diversified portfolio. Again, where you're building broadly, across different sectors, and the biggest part is the opportunity within areas, such as, valuation, yield, and momentum.

MLR: In terms of the domestic picture versus the international picture, last year was a better year than anybody expected, domestically, because nobody would have forecast 12 straight months of rising markets — let alone all of that increase coming after the political change in 2016! But relatively speaking, international markets — and particularly emerging markets — did better. How likely do you think that is going to continue?

Chris: You know, that is one where we could potentially see an increase. And again, this is one where we don't make calls on the specifics. But, if you go back a little bit further, on the 2013–2015 time frame the U.S. had outperformed international markets for a pretty significant period of time. So, this is one we have seen that there are multiple times where you have trends, over a 3- to 5-year basis, where you can see international outperforming domestic, versus domestic outperforming international. And this is why we also talk to clients about having a diversified portfolio, where you're allocated to both international and domestic strategies.

MLR: For investors who are looking at this, they're hearing you say, "We're long-term investors. We don't try to time the market. We want to be able to capture the long-term trends." But they also hear you talking about factor investing and, while you are different — and I've said that from the very first minute we started this interview — while you guys are different from most standard factor investment portfolio managers that I have on this show… well, they may not be market timers.

But they are very definitely looking at how to ride current waves, or where can they make hay while the sun is shining. So, how does your balance (or, help my audience understand the right balance) between long-term and factor make you different from the other guys?

Chris: Well, the important thing to understand about factor investing is that it all ties back to underlying fundamental financial concepts, right? So, the idea is that within our portfolios we do have cyclical trends that come through, and opportunities that come through, based on the characteristics. And you're going to see that through each of our themes: Value, Momentum, and Yield.

So, valuation is one [theme] where you're taking some form of financial metric versus what the market price is and looking for cheap opportunities that are out there. And you're going to end up having areas of the market that are going to wind up getting expensive — and cheap — relative to one another, which does give you different opportunities, and different rotations. So you can wind up with certain areas, like Biotechnology, that can look very expensive based on current operating metrics or certain areas of Technology.

Versus, you could have other areas within those that may look extraordinarily cheap and attractive. Same thing with Momentum. There tends to be a trend following investing [where] you'll see returns over the near term of the 6- or 9-months that have done very well. And those will have opportunities — particularly through things like M&A cycles, across various sectors — where you'll see appreciation and continued appreciation over a near-term holding period.

And same thing with Yield. There are areas where companies are buying back stocks aggressively or issuing dividends that attract evaluations, all of which can lead to ways that you're identifying companies and identifying trends. Now, part of what makes us unique is that we believe in taking active bets on those and trying to find ways [to select] the cheapest stocks, stocks with [very strong] growth characteristics with the [highest] return of capital, and then building a portfolio. We call this our Factor AlphaSM process: going through and trying to build a very active process to try to capture those.

So, where I say we are different, typically, is on how we identified characteristics. I think we do a very good job of identifying those characteristics. And then, we build our portfolios to try to maximize returns for clients.

MLR: We're almost out of time here, but you talked about trends. The hottest trend in the investment world, even though it may not actually be an investment in 2017, was BitCoin. I'm curious, given that you do quantitative modeling, how do you guys classify and think about BitCoin?

Chris: Well, for us, we're pretty equity-focused. But obviously, you can't go very far without having people talk about cryptocurrencies. And part of it is that it's a very nascent market, right? So, very early the data's going to continue to build. And we would not be surprised — in fact, we've done preliminary research, that are quantitative strategies that can be used to identify both trend following within the crypto-asset universe. So, my opinion is that, as that market continues to develop, the data's going to get better and you're going to start seeing more quantitative approaches applied to it.

MLR: And when we do — well, we'll see how that plays out. And, when we want to find out how it's playing out, hopefully we'll get a chance to chat with you again. Chris Meredith, thanks so much for joining me on the show.

Chris: Thanks, Chuck. I really appreciate it.

MLR: Chris Meredith is Director of Research and Senior Portfolio Manager at O'Shaughnessy Asset Management. If you want more information, OSAM.com is the website. Chris is on Twitter: @ChrisMeredith23.

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