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Dr. David Esch is the Managing Director of Research at New Frontier, having joined the firm in 2008. Dr. Esch completed his Ph.D. in Statistics at Harvard University in 2004. His specialties include mathematical statistics, numerical analysis and computation, Bayesian statistics, and econometrics. He is author of the article "Non Normality Facts and Fallacies," (Journal Of Investment Management 1st Quarter 2010), selected as one of the best JOIM papers of 2010, and co-author of many other peer-reviewed journal articles. His educational background also includes a Bachelor of Arts degree from Harvard College and a Masters degree in Mathematics and Statistics from Boston University.

New Frontier Has the Best Implementation of Strategic Investing in the Industry

by Dr. David N. Esch

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At New Frontier, we believe in strategic investing. We believe that markets are mostly unpredictable and that making directional bets on market performance or individual securities is largely a fool's errand. Over most time periods some securities increase in value, whereas others decrease, almost all unpredictably. With that understanding, the best investment strategy is to stay invested in a large basket of reliable index funds, so that the unpredictable price movements cancel each other.

However, in spite of the scarceness of reliable information, there are small signals from various sources that should be utilized to their full advantage. We believe that strategic can be enhanced with this information and better process. We implement strategic portfolios by holding a broad selection of ETFs, diversifying across all global risk factors, and using superior portfolio construction technology.

While there are other firms successfully implementing global strategic investment, we believe that our approach is superior in several ways. Our track record, presently spanning over 11 years, bears record to our superior investment process, which is implemented with disciplined precision, yet overseen by a committee with many years of collective experience to assure correct performance of the algorithmic components of our process. During the market downturn of 2008, our funds lost less than almost all competitors. Our conservative funds in particular did quite well. We believe that this outperformance in difficult markets is not just random luck but rather a product of our meticulously applied investment process. Managers come and go but we still are in business after more than 11 years.

We use a patented mathematical process to create our allocations to the selected funds. This process, Michaud Optimization, optimizes over thousands of market scenarios to create a portfolio that is best positioned for all foreseeable outcomes simultaneously. This process was deemed superior by the originator of modern portfolio theory, Doctor Harry Markowitz. We are the only managers using this asset allocation technology, and we believe it adds value to the investment process. In Dr. Markowitz's experiment, the Michaud Optimization process averaged 57 basis points of outperformance over the standard optimization techniques. The Michaud process is also dynamic, changing allocations with incoming information. Many of our competitors do not optimize at all, and just select an allocation with

“nice even numbers,” often fixed and nonresponsive to current market signals. Such an approach to asset allocation leaves investors’ money on the table.

New Frontier’s process starts by combining all available market signals, large and small, into a concise set of numerical summaries, to be used as inputs into the Michaud Optimization process. We use Bayesian statistical methods to attenuate noise and merge all information sources into a single set of inputs. This process produces cleaned up signals which are investment meaningful, responsive to changes in the markets, yet suitably stable for strategic investing when run through the Michaud Optimizer.

New Frontier’s technological process also produces useful information about when and how to trade. Many funds trade at regular intervals or with simple rules, regardless of fluctuating market volatility, which creates unnecessary trading costs or misses important trading opportunities. The patented Michaud-Esch rebalancing and trade advisor procedures isolate the important trades and remove any remaining noise-based trades from our system, creating an evolving portfolio that is responsive to market signals yet stable with relatively low turnover, and consistent with our strategic philosophy. This also helps our funds grow more efficiently.

While all strategic advisors avoid making directional forecasts, many do deliberately tilt toward certain risk factors beyond the overall market. New Frontier’s Global Strategic products capture these risk factors through the asset allocation process, since they are implicit in the numerical relationships between performance and co-movement of the asset prices, and neatly assimilated into our portfolio creation process. Many of our strategic competitors take a more explicitly active approach by using funds, such as “smart beta” or “factor investing” products, which are deliberately tilted toward factors, such as size, value, quality, or momentum. These funds individually perform well most of the time, but in combination may reduce or even cancel each other’s benefits. Besides, they often perform extremely poorly when their associated factors experience a downside economic cycle. Our asset allocation technology manages to capture the performance factors without needing to select funds with intentional active tilts.

Finally, New Frontier is dedicated to ETF investing. The ETFs in our funds are transparent, liquid, tax efficient, and low cost. We avoid ETFs with levered or short positions since we believe that they are risky and often underperform their targets, and we also avoid ETFs that are relatively illiquid, since they may cause difficulty in creating or liquidating redemption baskets for assets that are difficult to value. The list of underlying securities in each ETF is widely available, adding further transparency to our funds, in contrast to many mutual fund managers. We believe that that our ETFs are better for the investor than comparable mutual funds, which

may contain hidden fees and whose holdings may be unknown or difficult to price.

New Frontier's flagship Global Strategic portfolios hold over 20 ETFs, under continuous review. Since the inception of our funds, the availability of ETFs covering global asset classes has greatly expanded, and new and better ETFs continue to come on line year after year. The decision to trade into new products, or for any reason, is not taken lightly; however, when there are undeniable advantages to switching ETFs or including a new one in the portfolio we do our best to continue improving the portfolios and minimize negative impact. Our diversification is not simply across asset classes – we also diversify across providers to select the best performing ETFs in each asset class, balancing cost against performance, instead of working within a single fund family. We believe that our basket of ETFs is superior to most other managers, and we never cease to review and improve where possible.

New Frontier strives to bring institutional quality fund management directly to the investor. This philosophy is reflected from top to bottom of our carefully designed investment process, which is designed to adapt to changing markets while capturing the stability and superior risk management of strategic diversification.

This note was posted as an entry on New Frontier's investment blog on February 24, 2016. Read this entry and other posts at: blog.newfrontieradvisors.com.