

# Zebra taps into Australian liquidity

By Simon Mumme

The funds manager co-founded by Roger Ibbotson, Zebra Capital Management, has back-tested its liquidity-focused equities strategy in the Australian market and found evidence of persistent outperformance.

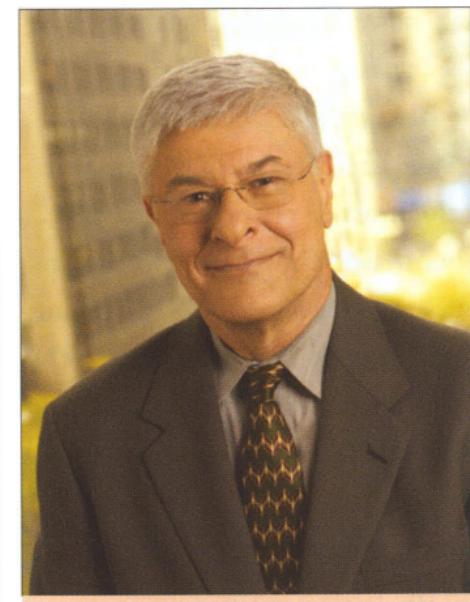
In back-tests covering the 15 years to 2010, Zebra found its 'liquidity-return' strategy outperformed the MSCI Australia index in all but three years: 1998, 2005 and 2006, when the market made strong gains.

Zebra showed defensive qualities as it outperformed in 72 per cent of the months when the benchmark fell by more than 3 per cent, but tended to deliver flat performance when the market fell by less than 3 per cent.

When markets ran strong, rising 3 per cent or more, Zebra outperformed in 39 per cent of all months, while it beat the benchmark in 59 per cent of months when the market rose between zero and 3 per cent. Throughout the back-test period, the strategy delivered a beta of 0.83.

Due to US hedge fund regulations, Zebra was unable to disclose publicly the exact returns generated by the tests.

The strategy, which favours less-liquid stocks, is based on Ibbotson's research finding in 1984 that a risk premium for lower liquidity exists among listed equities. This has been substantiated by further research papers undertaken by Ibbotson, fellow Zebra co-founder Zhiwu Chen and numerous others over the years.



**Roger Ibbotson** ... most listed equity investors don't see liquidity as a premium

Traditional risk premiums in public markets, such as equity, size and value were well-known, Zebra said. But liquidity, as a premium – which existed in private equity, venture capital, real estate, bond markets and in public equity markets – had been ignored or "assumed away".

The manager found that more liquid stocks were priced at a premium, and that less-liquid stocks were priced at a discount and generally had higher prospective returns.

Zebra also drew on the theory of mean-reversion by avoiding highly traded glamour stocks in preference of out-of-favour companies with sound fundamentals. "Individual stocks revert towards mean liquidity, while moving in and out of favour," Zebra stated.

Ibbotson is Professor of Finance at the Yale School of Management, and founded the now Morningstar-owned Ibbotson Associates, which advises about US\$60 billion through investment consulting, portfolio implementation and capital markets guidance. ■