

BRV Index-TS

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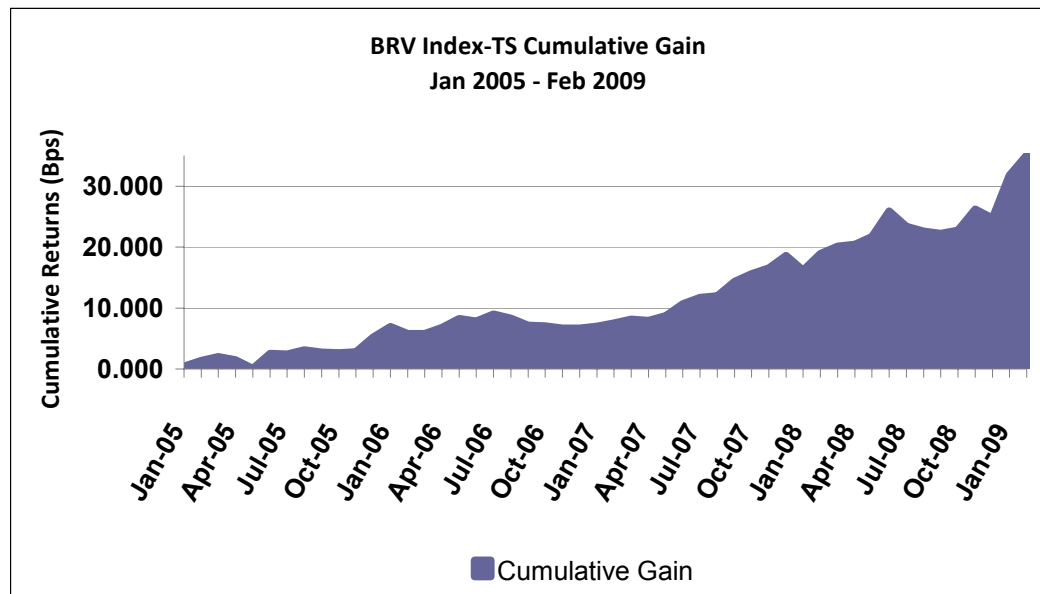
Enhanced Indexing

Extending 1xx/xx Enhancement to the Trading Desk

In recent studies (*BRV 500 Plus – (1/20/09)*, *BRV-500SR – (11/17/08)*) we have identified and demonstrated ways to effectively implement index enhancement of a “1xx/xx” form. In these studies we have shown the ability to generate consistent positive enhancement to an underlying benchmark in turnkey fashion, through the use of single index mean/variance techniques. The *BRV 500 Plus* structure employs an alpha portfolio as the “tilt” with a corresponding index wrap composed of the remaining stocks in the benchmark, while the *BRV-500SR* form uses the alpha to re-allocate the weights of all benchmark stocks as an offset to their index position. The underlying metrics of each design remain that they are structures that order stocks by magnitude from best to worst for both selection and construction (weighting) purposes.

It is widely noted that the concept of enhancement is portable not only to disciplined portfolio overlays, but to more nimble trading strategies as well. Among the most well known of these implementations is the Pairs Strategy. The Pairs Strategy is a market-neutral vehicle designed to add absolute returns through its natural arbitrage position. The trader identifies two stocks of similar correlation, taking a short position in the one deemed to underperform and a long position in the one deemed to outperform. It is a short-term strategy that seeks to capture returns through the expected divergence in relative performance, while maintaining a measure of risk control through the matching volatilities.

We approach the trading strategy enhancement in slightly different fashion. Unlike the traditional pairs strategy that seeks a correlation match of the underlying stocks, our implementation is an extension of the aforementioned fundamental enhancements. Because we deploy our ordered fundamental measures in an equal “over/under” mix, it is not necessary for us to identify matching correlations, nor does it suggest a need to settle the corresponding arbitrage positions in a short period of time. Instead, the requirement is that our alphas be robust in ordering stocks from most-to-least desired. To the extent that they are able to achieve that requisite, our strategies will realize consistent positive cumulative enhancement in kind, with risk control appropriately measured through the scale of the bets.



Source: Blaylock Robert Van, LLC