



Navigating a Bearish Outlook: A Dual-Strategy Approach to Quality Value and Quality Growth

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Abstract. The following report provides an overview of our management of our portfolio. We implemented two main investment strategies based on a pessimistic macroeconomic forecast. These were a quality value strategy and a quality growth strategy. We put equal emphasis on both of the strategies, allocating 40% of the portfolio to each, and the remaining 20% was reserved for any potential tactical opportunities. Overall, the portfolio depreciated, but was successful: marginally outperforming the benchmark. However, this was mostly due to the portfolio accidentally mimicking a low-volatility strategy and unexpected market events. From our time managing the portfolio, we were also able to make several key learnings. We learned how to more optimally allocate funds among securities, as well as how to efficiently allocate group roles. Most importantly though, we learned that conducting extensive research, and creating appropriate weights to avoid impulsive spending and align the portfolio with our goals is paramount to future successful investing.

Keywords: Portfolio management, Quality investing, Pessimistic macroeconomic forecast

1 Introduction

This report provides an overview of the management and performance of our investment portfolio. Based on a pessimistic macroeconomic forecast—expecting declining capital markets driven by persistent inflation, rising interest rates, and an inverted yield curve—we implemented two distinct investment strategies: a quality value strategy and a quality growth strategy. Each strategy was allocated 40% of the initial portfolio, with the remaining 20% reserved for tactical opportunities and short positions.

Over the project period, the portfolio depreciated in absolute terms. However, it marginally outperformed the benchmark. This outcome was not primarily driven by our intended strategic positioning. Instead, outperformance resulted largely from two factors: the portfolio inadvertently mimicking a low-volatility strategy, and unexpected market events, most notably the failure of several major banks, which benefited our fixed-income holdings.

The remainder of this report is structured as follows. Section 2 details the macroeconomic forecast underpinning our strategies, followed by a description of the quality

value and quality growth approaches. Section 3 analyzes portfolio performance, including security selection, risk-adjusted returns, and benchmark comparisons. Section 4 presents key learnings from the management experience, focusing on capital allocation, group role efficiency, and the importance of research-driven decision making for future investing success.

2 Investment Strategies

Prior to devising our investment strategies, we generated a forecast of the macroeconomic environment over the next three years to ground our strategies in. Once we had generated our forecast, we chose two different investment strategies and split the portfolio into two corresponding sub-portfolios. This was done so group members would have similar workloads and levels of responsibility, as well as to create a minimum level of portfolio diversification. The first strategy was to invest in large-capitalization, value securities, identified using a top-down approach; and the second strategy was to invest in large-capitalization, quality, growth securities, identified using a bottom-up approach. 40% of the starting portfolio was allocated to the value strategy, 40% was allocated to the growth strategy, and the remaining 20% was reserved for short positions and tactical opportunities.

2.1 Macroeconomic Environment Forecast

We forecasted a decline in capital markets within the next 3 years. This forecast revolved around 3 main factors: 1) softening consumer demand due to high inflation (Figure 1); 2) increasing interest rates (Figure 2); and 3) rising market bullishness (Figure 3). Consumer demand has decreased due to reduced purchasing power from high inflation (Kalish, 2023). In turn, we expect consumers to purchase less, thereby negatively affecting corporate profits and growth. To combat the high inflation, central banks have raised interest rates aggressively, further weighing down on consumer purchasing power, as well as reducing business investment by rendering it more costly (Kalish, 2023; Wright et al., 2023). Despite these factors, capital markets remained bullish, even becoming more so (CNN Business, 2023). As such, we expected that some securities would be overvalued stocks and others would be undervalued, presenting opportunities to outperform the market. Furthermore, the US Treasury yield curve was inverted (Figure 4), which supported our forecast that a recession was on the near horizon (Federal Reserve Bank of St. Louis, 2023).

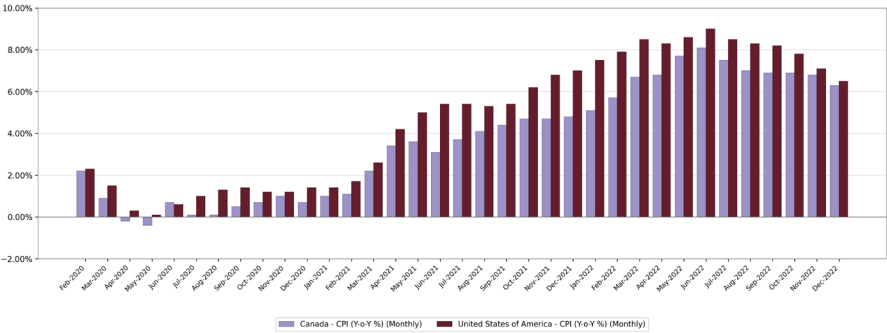


Fig. 1. Canada and USA Monthly CPI (Year-on-Year) From 2020-2022 (Capital IQ, 2023)

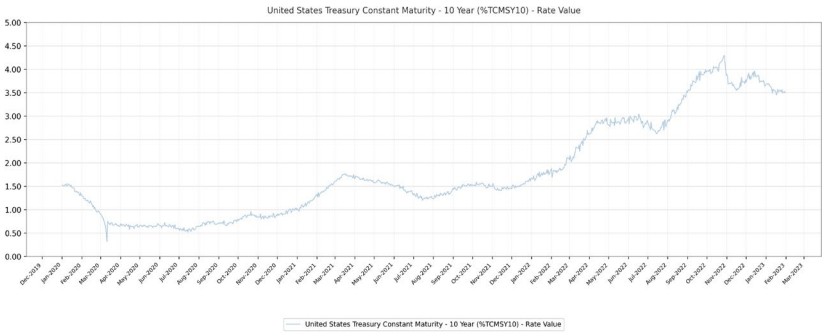


Fig. 2. US Treasury Constant Maturity - 10 Year (%TCMSY10) - Rate Value (Capital IQ, 2023)

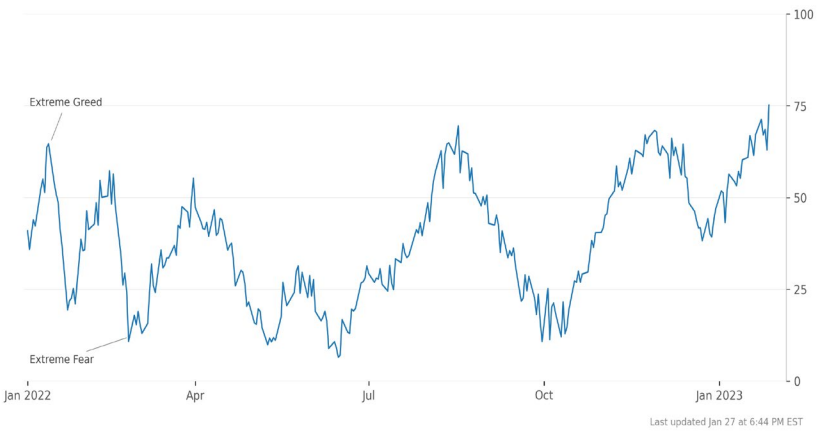


Fig. 3. CNN Fear & Greed Index From Jan 2022 - Jan 2023 (CNN Business, 2023)



Fig. 4. 10-Year Treasury Constant Maturity Minus 2-Year Treasury Constant Maturity (Federal Reserve Bank of St. Louis, 2023)

2.2 Quality Value Strategy

Based on our economic forecast, we adopted an investment strategy that focuses on large-capitalization value companies with strong fundamentals. Our goal is to identify underpriced companies that can weather a potential recession. To achieve this goal, we use several screening criteria, including a market capitalization greater than \$10 billion USD, a dividend yield of 10%, a forward price-to-earnings ratio of less than 18, a price-to-book value ratio of less than 15, and headquarters in North America. By selecting companies with a market capitalization above \$10 billion, we aim to identify firms with a proven track record of performance and financial stability that are less likely to fail or file for bankruptcy during market declines (Fidelity, 2023). We also prioritize companies with a dividend yield higher than 10% to generate steady income during market downturns. Our screening criteria of a forward price-to-earnings ratio less than 18 and price-to-book value less than 15 helps us to identify undervalued companies that may have strong long-term growth potential (Berger, 2022). Lastly, we focus on North American companies to avoid geo-political risks that arise from investing in countries with or vulnerable to geo-political instability. We expect selected securities will be resistant to economic downturns and are able to provide stable cash flows through dividends resulting in steady returns over the long term.

2.3 Quality Growth Strategy

Based on our economic forecast, we implemented an investment strategy that focuses on large-capitalization growth companies with strong underlying fundamentals. Our goal is to identify companies that can deliver growth, even during a recession. To accomplish this, we screened companies using the following major criteria: a market capitalization > \$13 billion USD, net income and revenue growth > 25% over the past year, net income and revenue growth > 20% CAGR over the past 2 years, annual EPS growth > 25% over the past year, and headquarters in North America or Europe. By screening for firms above a \$13 billion capitalization, we remove smaller firms that are less established and less likely to survive a recession (Fidelity, 2023). The choice of \$13 billion is to align with Standard & Poor’s eligibility requirements to be a part of

the S&P 500, which we use as a high-level measure of stability (S&P Dow Jones Indices, 2023). The net income and revenue criteria allow us to identify companies that have experienced rapid, sustained growth. While past performance does not necessarily predict future performance, we believe that current growth creates opportunities for further growth, and that growing firms may not have completed their current growth. Our EPS growth criteria is to ensure that any firms identified are generating additional value for shareholders through their growth. We noticed during initial screenings that many companies were based in emerging markets, and we do not believe that these firms are suitable, given their elevated geo-political, economic, and currency risks. Thus, we introduced the additional criteria that firms be headquartered in North America or Europe.

3 Portfolio Performance Analysis

Overall, the portfolio depreciated over the course of the project, hence the Sharpe Ratio of 0. Compared to the benchmark, the portfolio tended to underperform the benchmark, until the final week of the project when it mildly outperformed. This trend is because the portfolio comparatively minimized losses compared to the benchmark, but commensurately sacrificed some gains, evidenced by the relatively low beta of 0.75. Referring to Figure 5, we find additional support for this explanation, as the portfolio consistently lost less than the benchmark in contractionary periods and gained less in expansionary periods.

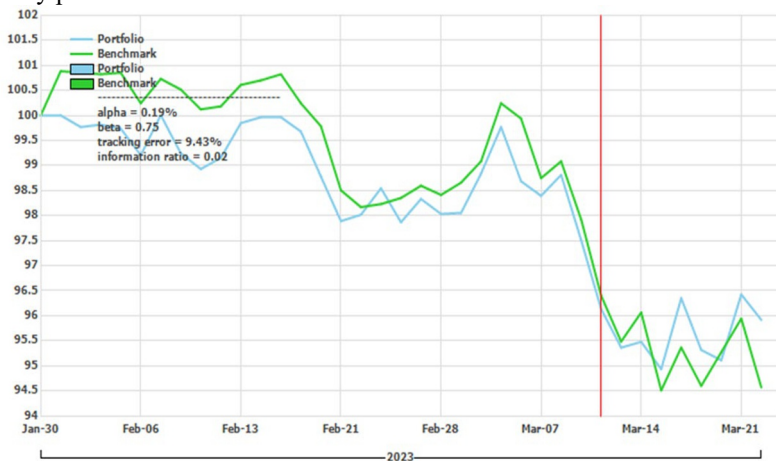


Fig. 5. Portfolio and Benchmark Values January 30 - March 24, 2023

Looking at the portfolio's security selection, the high tracking error of 9.43% shows that the portfolio made substantial efforts to identify securities that would outperform the benchmark. In this, the portfolio was successful, with three of twelve selected securities appreciating. The remaining nine securities depreciated, but each depreciated less than the benchmark, yielding a weighted average loss less than the benchmark's (Figure 6) sfor a full breakdown of the securities and their performances). Again, Figure

5 provides visual support. As such, the portfolio attained a low, but positive, alpha of 0.19%. In combination with the low information ratio of 0.02 then, the portfolio derived its outperformance from security selection, but only marginally. However, a deeper examination of the winners and major losers bears merit. On the winning front, the portfolio’s fixed-income ETFs saw their values greatly boosted, with the failure of major banks. These banks failed as their large long-term bond holdings were severely depreciated by continuous interest rate hikes to combat inflation, leaving them with insufficient funds to cover clients’ deposits (Murray, 2023). In fear of further contagion, investors fled to government bonds, driving their prices up (Li, 2023). This flight to quality also explains the portfolio’s losers, which were focused in the financial sector and negatively impacted the fears of contagion.

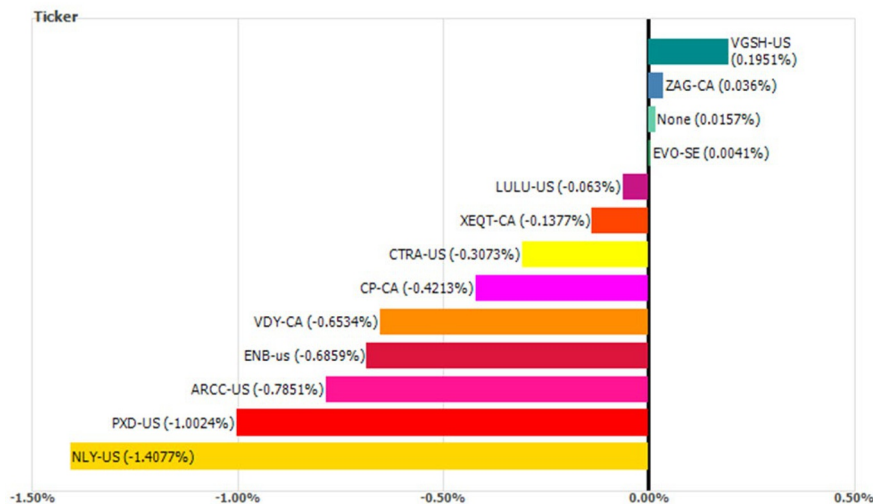


Fig. 6. Security Gains/Losses, as a Percent of Individual Value

4 Key Learnings

As a group we allocated tasks among group members, significant communication was required to determine each group member’s individual strengths and weaknesses for the project. In the course of communicating, we determined which group members were best suited to the strategies we had selected. Michael Flynn and Haneol Park, being the most familiar with top down approach strategies, were in charge of investing in large-cap value securities identified using fundamental valuation alongside a top-down approach. Haoyu (Rock) Chen and Kevin Lai on the other hand took responsibility for investing in large-cap growth securities identified using fundamental valuation alongside a bottom-up approach given their greater experience in using Capital IQ to screen and analyze companies. Sherry, possessing the most extensive knowledge regarding fixed income securities, was responsible for the selection of fixed income securities. By assigning responsibilities according to group members’ strengths, we ensured that the portfolio was optimally managed (in terms of relative skill).

Over the course of the project, we have learned three major lessons that should be carefully considered before starting any personal finance projects. First, staying up to date with current economic and market developments is crucial to maximize opportunities and minimize losses. Major events such as the collapse of Silicon Valley Bank led to major market volatility and provided new information that presented unique opportunities to make tactical portfolio shifts. Second, setting financial goals and target asset weights helps to prevent impulsive transactions and better aligns the portfolio with our desired investment outcomes. Third, we have learned about the importance of diversification. This proved to be valuable when the Silicon Valley Bank collapse occurred, causing the financial sector to underperform. Due to the uncertainty surrounding the health of banks, customers started to withdraw their deposits, leading to a negative impact on the finance sector stocks. However, thanks to our diversified portfolio (see Figure 7), the losses incurred from the finance sector were mitigated. While our stocks in the finance sector did take a hit, the overall effect on our entire portfolio was lessened due to our exposure to other sectors, especially government bonds.

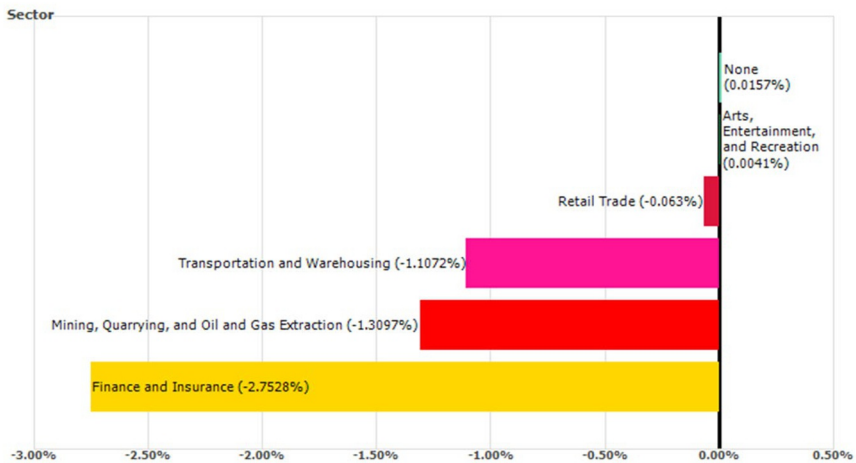


Fig. 7. Portfolio sector performance analysis

5 Conclusion

Our portfolio management exercise yielded results that, while modestly favourable on the surface, warrant careful interpretation. The portfolio depreciated in absolute terms over the project period yet marginally outperformed its benchmark, achieving a positive alpha of 0.19% alongside a Sharpe ratio of 0 and an information ratio of 0.02. Examined critically, however, the sources of this outperformance were not those we set out to engineer. The portfolio's low beta of 0.75 caused it to inadvertently mimic a low-volatility strategy, sheltering it from drawdowns but also limiting upside participation. More consequentially, the failure of Silicon Valley Bank and the broader regional banking turmoil in March 2023 produced a flight to quality that disproportionately benefited our

fixed-income allocations—a tailwind we did not anticipate when constructing the portfolio.

This gap between intended and realized sources of return is, in our view, the most important finding of the project. It cautions against the temptation—common in both academic and practitioner literature—to retrospectively rationalize investment outcomes as the natural product of strategic foresight. In our case, the macroeconomic theses underpinning our positioning materialized broadly as expected: inflation remained elevated, interest rates continued to rise, the yield curve remained inverted, and a recessionary signal did emerge in the form of the banking-sector dislocation. Yet the proximate mechanism through which our portfolio profited was idiosyncratic rather than thematic, and honest acknowledgment of this distinction is, we believe, the foundation of better investment practice going forward.

Several practical lessons follow from this assessment. First, real-time engagement with developing market events is not optional in active portfolio management; both the loss-mitigation and the gain-capture from the March 2023 banking events depended on it. Second, *ex ante* portfolio construction—explicit target weights, sector limits, and risk parameters—disciplines decision-making during volatile periods, when impulsive trades are most tempting and most costly. Third, diversification across sectors and asset classes is justified empirically as well as theoretically; it was our exposure to government bonds, more than any single equity decision, that cushioned the portfolio when financial-sector holdings underperformed.

Several refinements suggest themselves for future iterations of this exercise. A more deliberate risk-budgeting framework—assigning *ex ante* volatility contributions to each sub-portfolio rather than equal dollar allocations—would have made our defensive posture intentional rather than incidental. More frequent reassessment of macroeconomic conditions, perhaps on a fixed weekly cadence, would have allowed the portfolio to respond more nimbly to the rapidly evolving rate environment. A clearer separation between strategic positioning, tied to longer-term theses derived from the macroeconomic forecast, and tactical opportunism within the 20% flexible allocation would also have helped distinguish skill from luck in performance attribution.

Ultimately, this experience reinforces a perspective often emphasized in the value-investing literature but easily lost in practice: that disciplined research, clearly articulated *ex ante* objectives, and intellectual honesty about the sources of return constitute more durable foundations for investment success than the appearance of having anticipated any particular market outcome. The next portfolio we manage will be informed by these lessons more than by the specific securities we selected this time.

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