



Portable Alpha

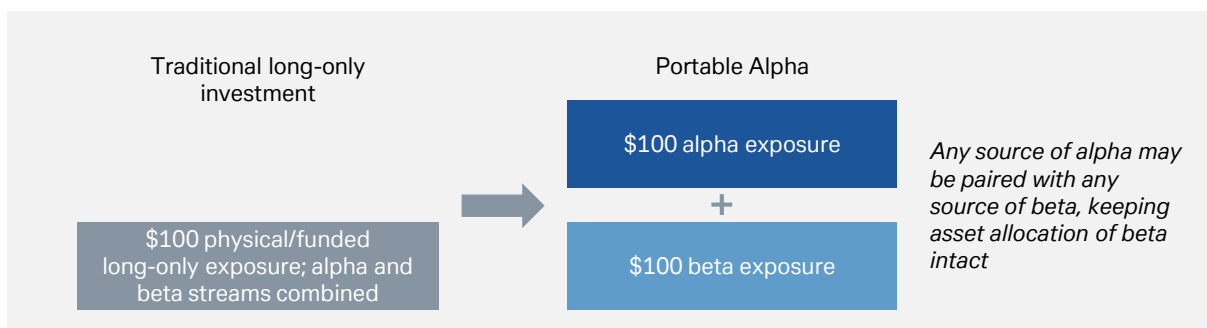
Introduction

Portable Alpha is a concept that emerged in the 1990s and early 2000s and has since been implemented by large allocators. In recent years, the topic has seen a resurgence.

The basic idea of portable alpha is to add uncorrelated alpha (“skill”) to an existing portfolio without disrupting its original, core asset allocation (“beta”). This typically involves separating the alpha and beta components of the portfolio to allow for independent and flexible management of each exposure.

In this paper, we highlight an efficient approach to Portable Alpha, which uses unfunded managed accounts to overlay liquid alpha, managed by third-party investment managers, onto funded (or unfunded) beta: **Deutsche Bank’s dbSelect platform**.

Figure 1: The Principle of Portable Alpha



Key considerations for choosing the Alpha component of a Portable Alpha portfolio

The premise of Portable Alpha is that the fundamental asset allocation choices of the investor can remain unchanged – hence we assume that the investor has already determined their beta allocation.

We therefore focus on how to select the alpha return streams. Over the many years since the emergence of Portable Alpha, the criteria for selecting the alpha return streams have largely remain unchanged, and are broadly agreed upon to be the below:

- ① **Liquid:** capital lock-ups may negatively affect overall portfolio performance over periods of market stress. In implementations where the beta is accessed on swap/margin, liquidity may be needed to fund margin calls. Therefore, the higher the liquidity of the alpha return stream, the more can be allocated to it, with confidence that exposure to the alpha stream can be adjusted easily to match any changes to the associated beta exposure.
- ② **Uncorrelated** to investor’s beta exposures (equity beta, bond beta, etc.), and in the case of having multiple alpha sources, low correlation between alpha sources
 - Material beta exposure would mean allocation to the alpha return stream could have a noticeable unintended impact on the underlying asset allocation
 - Even alpha sources with lower Sharpe ratios than the portfolio Sharpe ratio can enhance returns if their correlation to the other alpha streams (or the associated beta exposure) is low or negative. This includes but is not limited to hedging strategies.
- ③ **Experience and track record:** Strong live track record through various market cycles, demonstrating ability to generate alpha consistently



Portable Alpha

Implementing Alpha within a Portable Alpha portfolio

The conventional implementation of Portable Alpha for many years was to (i) sell the funded beta exposure (stocks, bonds), (ii) replace the beta exposure with unfunded derivatives (futures, swaps) and (iii) use the cash generated to invest in the alpha component of the portfolio (hedge funds or other managed investment vehicles).

This was driven by the fact that alpha strategies are typically only available via funds (commingled or otherwise) while exposure to equities and fixed income beta could be accessed via futures or other derivatives.

The main challenge then, for alpha allocations, was on liquidity, since most sources of alpha typically came from hedge fund strategies, whose redemption cycles were commonly quarterly, often with multiple months' notice period.

Fortunately, over time, alternative ways to implement alpha have become available which have made significant improvements on the liquidity profile of alpha return streams available for implementation in a Portable Alpha portfolio.

Figure 2: Typical spectrum of alpha implementations available to investors

Pooled vehicles (traditional hedge funds)	<ul style="list-style-type: none"> Fully funded Commingled investment vehicle with typically low transparency to investors Liquidity terms offered to investors have improved over the years; some funds now offer liquidity as frequently as daily, though many remain monthly/quarterly
Dedicated investment vehicles (funds-of-one or managed accounts)	<ul style="list-style-type: none"> Fully funded or partially funded Strategy may be customisable and/or more transparent May offer improved liquidity reflecting more closely the liquidity of the underlying instruments Heavy legal and operational set-up burden; high minimum investment levels
Fund derivatives (access to hedge funds via total return swaps, fund financing facilities, collateralised loan facility)	<ul style="list-style-type: none"> Partially funded or collateralised exposures Various payoffs available (e.g. leverage, capital protection, capped loss) Underlyings are the actual pooled vehicles (see first entry) – limited liquidity and transparency Financing costs can be punitive and alpha performance would have high breakeven hurdles to make this route economically viable
dbSelect (hedge fund managed account platform)	<ul style="list-style-type: none"> Partially funded and fully unfunded solutions available Managed account structure supports access with capital and cost efficiency Various payoffs available (e.g. leverage, capital protection, capped loss) Daily liquidity and transparency Low minimum investment levels



Portable Alpha

dbSelect: a natural home for alpha

dbSelect is Deutsche Bank's managed account platform providing investors with access to liquid hedge fund strategies with daily liquidity, capital efficiencies and DB risk oversight. dbSelect is able to offer unfunded and partially funded access to a wide array of alpha return streams managed by third party investment managers, with various payoffs (linear, options, capped loss, capital protection).

The platform was launched in 2004 and has over 20 years of operating history, including over the Global Financial Crisis and Covid-19. The platform has housed hundreds of hedge fund strategies over the years, ranging from household names to niche managers to custom mandates for single institutional investors.

Portable Alpha consideration	dbSelect
① Liquidity	<ul style="list-style-type: none"> ✓ Strategies have daily liquidity by virtue of having an investment universe of only highly liquid underlying instruments ✓ Investors are able to reallocate dynamically between strategies if so desired, for example to implement a tactical alpha allocation
② Uncorrelated	<ul style="list-style-type: none"> ✓ The majority of dbSelect strategies have low long-term correlation to equity beta, as well as fixed income beta ✓ Figure 3 shows further information on individual strategy correlation to traditional asset classes
③ Experience and track record	<ul style="list-style-type: none"> ✓ A wide universe of strategies is available on dbSelect, many of which have long live track records, withstanding various financial stress periods

Figure 3: Correlations to traditional betas for dbSelect strategies



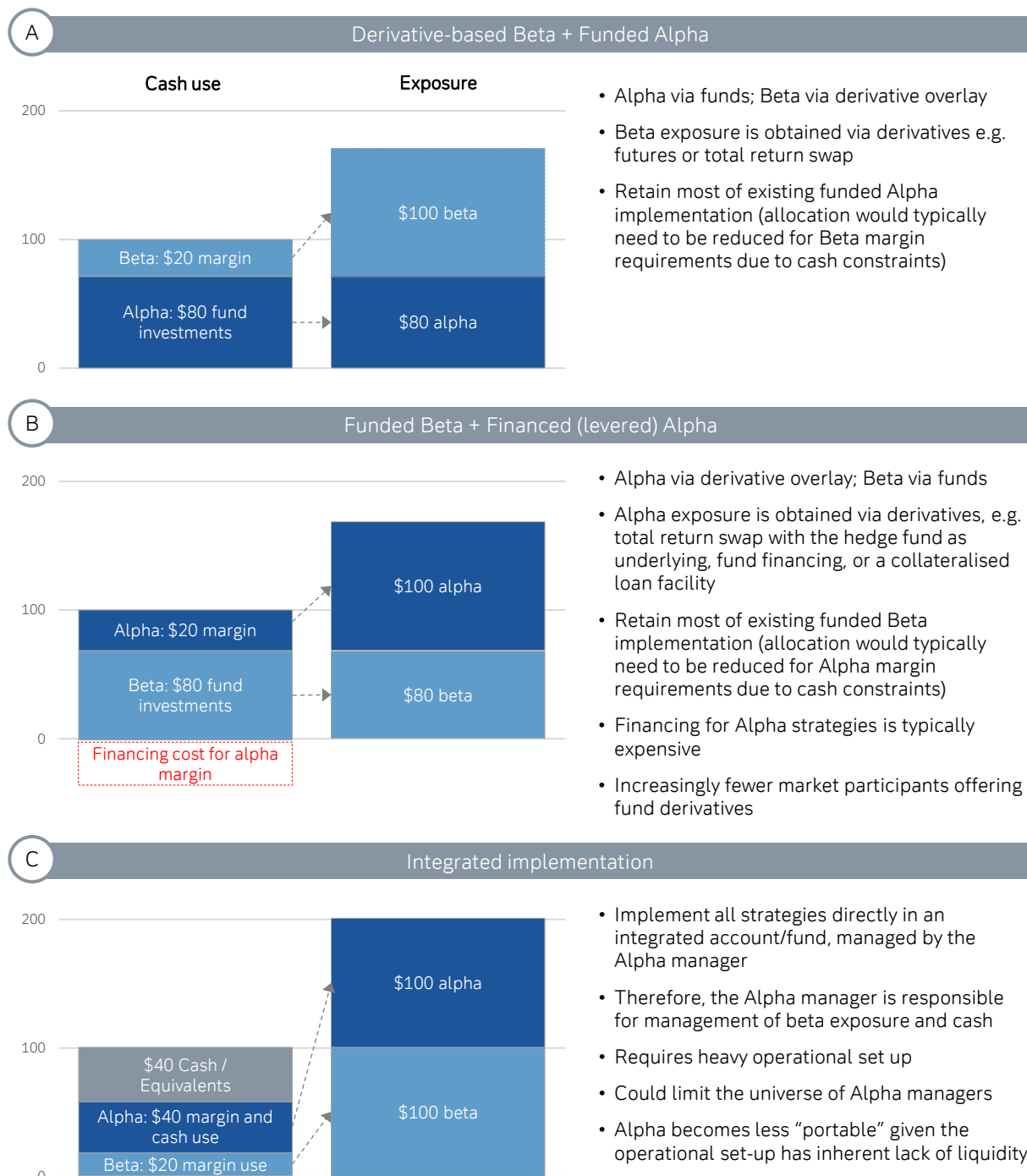
Source: Deutsche Bank AG, Bloomberg LP. "Equities" is represented by the MSCI World Net Total Return USD Index (NDDUWI Index), "Bonds" is represented by the Bloomberg Global Aggregate Total Return USD Index (LEGATRUU Index). Observation period: 31-Dec-07 (or each strategy's inception date, if later) to 10-Jul-25. Correlation data has been calculated based on weekly returns data. Past performance is not a reliable indicator of future results. The above data on individual manager correlations should not be seen as DB's investment advice and/or recommendation or endorsement of certain dbSelect strategies over others.



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Traditional implementations

Traditional implementations typically obtain the investor's beta exposure by using derivatives (e.g. futures or total return swap) due to limitations on access routes for alpha return streams. Unless the investor takes the fund financing route, existing funded beta allocations must be overhauled in order to implement Portable Alpha.





Portable Alpha

Transforming a core asset allocation into an overlay...
...not necessarily as straightforward as it looks

Most traditional implementations of Portable Alpha require an investor to overhaul their existing funded asset allocation (beta) to a degree, as they rely on getting beta exposure via a derivative overlay. Even in route (B) shown previously, where it is the alpha that the investor accesses as an overlay rather than the beta, there is still some divestment from its funded beta investments needed in order to finance the margin required for the alpha overlay.

Why does it matter whether the beta exposure is disrupted or not? There are numerous reasons why an investor may wish to retain existing investments as far as possible:

- Redemption of (beta-related) fund investments may trigger an unwanted tax event
- Existing vehicles through which the beta has been implemented may have been optimised for tax and/or capital efficiency, meaning any changes thereto are automatically undesirable
- A desire to continue capturing any alpha generated by active managers of (predominantly) beta exposures
- Retention of voting rights, investment credits/quotas, cross-holdings or other non-financial benefits of directly holding the relevant securities

Traditional implementations of Portable Alpha therefore may at times appear compromising or sub-optimal to an investor who has spent years building an asset allocation implementation worth preserving.

dbSelect implementations

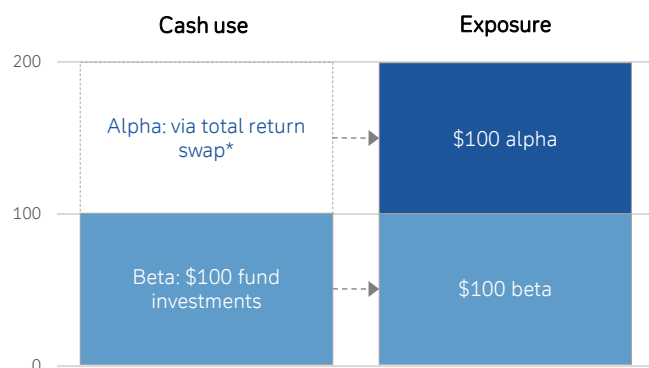
The dbSelect platform allows for additional Portable Alpha implementations, each providing flexibility and/or distinct pay-off features.

Crucially, with dbSelect the investor is able to implement their alpha exposure with minimal or no disruption of their existing beta mandates. It also allows investors to capture any alpha generated within their "beta" implementations and mandates, rather than limiting the beta exposure to "benchmark-only" investments by default.

D

Derivative-based Beta + Funded Alpha

The dbSelect platform hosts liquid alpha strategies implemented in managed accounts; as such, it is possible for investors to gain exposure using cash-efficient, margin-based total return swap structures with Deutsche Bank. This implementation structurally provides cheaper cost of capital per unit of levered exposure compared to traditional hedge fund levered or financed solutions, which attract high financing costs from leverage providers.



- Alpha via derivative overlay; beta via funds
- Retain existing funded Beta allocation
- Alpha is accessed via derivatives without being linked to any underlying fund vehicle as in implementation (B) above
- Depending on the strategy, investor can work with their existing Alpha manager(s)

*Possibility for no requirement of initial margin, depending on investor type and specific transaction.



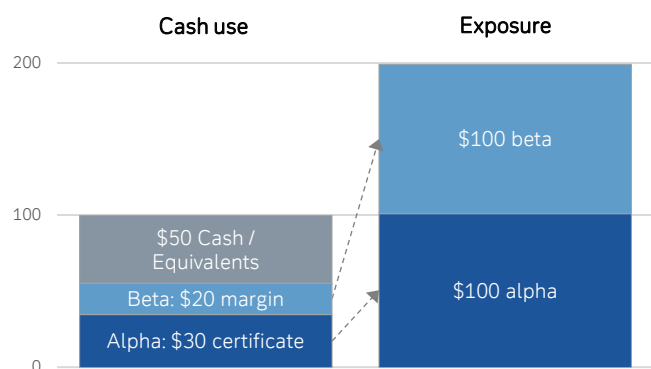
Portable Alpha

dbSelect implementations

E

Alpha with capped loss

One of the challenges and risks of Portable Alpha is the introduction of unwanted downside risk, especially in scenarios when alpha strategies become correlated with market downturns, potentially leading to losses that outweigh the intended benefit of the Portable Alpha solution. dbSelect can help deliver the alpha streams with capped-loss structures, such as options linked to portfolio of hedge fund strategies or swaps with contractual max loss guarantees. This way, allocators can gain greater confidence in adopting Portable Alpha solutions, knowing that downside risk and losses are contractually capped or mitigated.

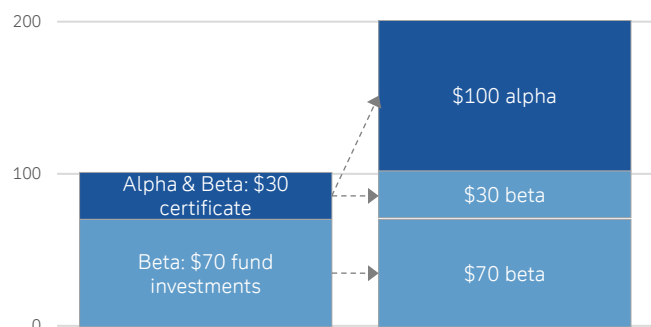


- Similar to the familiar beta overlay solution in implementation (A)
- Additional capped loss feature for the alpha exposure as maximum loss possible for the alpha component is capped at the notional value of the certificate
- Fully capital-protected implementations are also available
- While the diagram shown is similar to that of implementation (B), no additional vehicle is required, and allocation to each component is managed directly by the investor

F

Funded combination (leverage without OTC derivatives)

An investor may face legal, regulatory or operational restrictions preventing them from entering into OTC derivatives or employing traditional leverage techniques. As a solution, DB is able to wrap and deliver the performance of liquid alpha strategies from the dbSelect platform in securitised format, e.g. with DB-issued notes or certificates; these are cash-funded instruments which provide notionally levered exposures to the strategies.



- Alpha exposure is captured in levered certificate, which can also provide embedded beta exposure
- Retain existing funded beta allocation to a large extent
- Investment wrapper for Alpha exposure is a security which can provide balance sheet simplicity
- No need for ISDA set-up

While the dbSelect implementation offers compelling opportunities, it is important to consider the associated risks and potential drawbacks of using dbSelect for a portable alpha implementation, such as:

- The solution can be used as an implementation for liquid strategies only, whose underlying instruments are supported by dbSelect (typically managed futures, global macro, FX, commodities, option-based and volatility trading strategies).
- Since dbSelect implementations are accessed via products sold by Deutsche Bank, such an investment would introduce counterparty exposure to Deutsche Bank



Portable Alpha

Conclusions

Portable Alpha is an investment approach which can be implemented in multiple ways, however “traditional” implementations typically require an overhaul of the implementation of an investor’s core asset allocation. Deutsche Bank introduces alternatives to the traditional implementations of Portable Alpha, offering (a) the ability to retain core asset allocation implementations, (b) enhanced payoffs such as capital protection, and (c) inherent liquidity in the alpha allocation.



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Contact information:

dbSelect.info@db.com	
London	+44 207 54 55385
	+44 20 754 59328
New York	+1 212 250 2268
	+1 212 250 3593
EEA	+49 69 910 40307
Singapore	+65 6423 5351