

SPECIAL REPORT

Finding alpha with new technologies

By Fazila Manjoo, portfolio manager, Mergence Investment Managers

By ignoring growing market concentration and new technologies, traditional fund managers are less resilient to market risk. Fazila Manjoo explores why using a systematic investment approach is attractive today, regardless of which stocks become or stay magnificent.

The past decade has been challenging for active fund managers in aggregate. Increased competition and a global market dominated by a handful of stocks have likely been contributing factors. Investment managers should be raising both eyebrows when they consider that the Magnificent 7¹ stocks have increased from a weight of about 6% in the MSCI World Index 10 years ago to over 24% today. Concentration has increased not just of the top stocks, but also of the US technology sector. Overall, US stocks now represent 72% of the MSCI World Index, a leap from the 58% exposure it held 10 years ago.²

The South African global equity landscape is largely biased to traditional stockpickers that tend to hold concentrated investment portfolios with high-conviction holdings. The recent dominance of US mega-cap stocks has increased performance dispersion of these managers. The best-performing benchmarks have been difficult to beat, as increased market concentration has made it harder for them to express their views.

Chart 1 explores how global equity markets continue to be dominated by seven stocks. In 2024 the Magnificent 7 stocks contributed 39% of the return of the MSCI World Index (up 18.9% in US dollars). Nvidia alone delivered 18% of the global market return. After solid

performance, the Magnificent 7 retreated in the first quarter this year, driving market losses. In the second quarter this reversed again, with the seven stocks driving significant performance again. Many managers would tell you that success today depends on whether you own these seven stocks, or not.

A SYSTEMATIC APPROACH CAN OFFER REFUGE

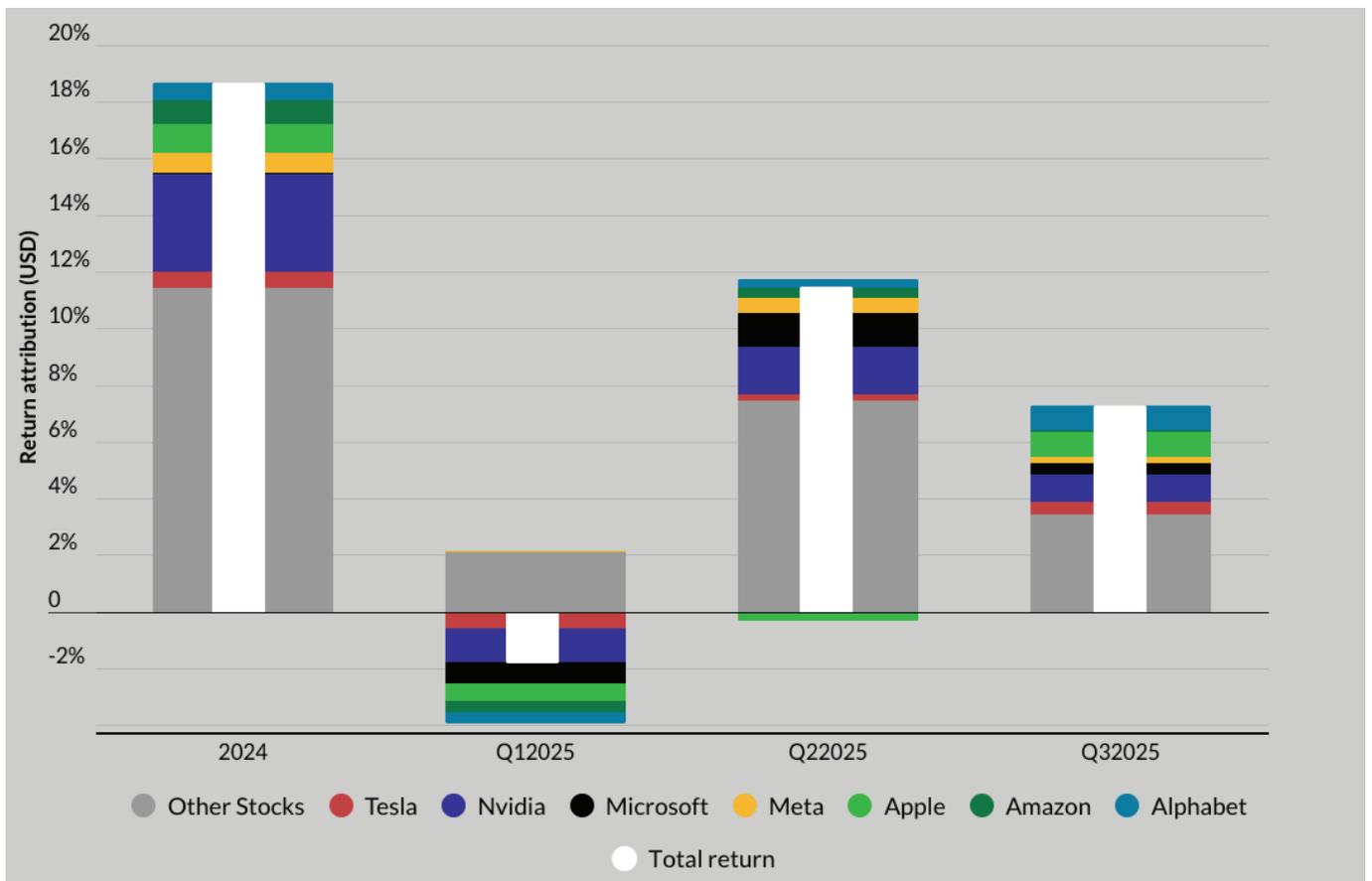
Are all global equity managers affected equally by the challenges of market concentration? I would argue no. Systematic managers³ by philosophy and design offer a refuge from concentrated risks. They are a category of managers that build diversified investment portfolios and seek exposure to risk factors, rather than focusing on a few concentrated bets in individual companies.

It is this sharp focus on risk management that offers insulation. You can think of a systematic process as a thermal blanket, a system that creates a barrier against unintended risk transfer in order to maintain stable performance.

How does this barrier work? While the concept of diversification is well understood, the return implications can be significantly underestimated. Traditional active managers hold concentrated portfolios with fewer stocks than a typical systematic manager. This concentrated approach exposes them to binary outcomes when a few stocks are driving the market.

In contrast, quants⁴ hold a large number of stocks spread like a blanket across the market ie: across regions, industries, and market cap

Chart 1: How the Magnificent 7 stocks have driven the MSCI World Index's gains and losses

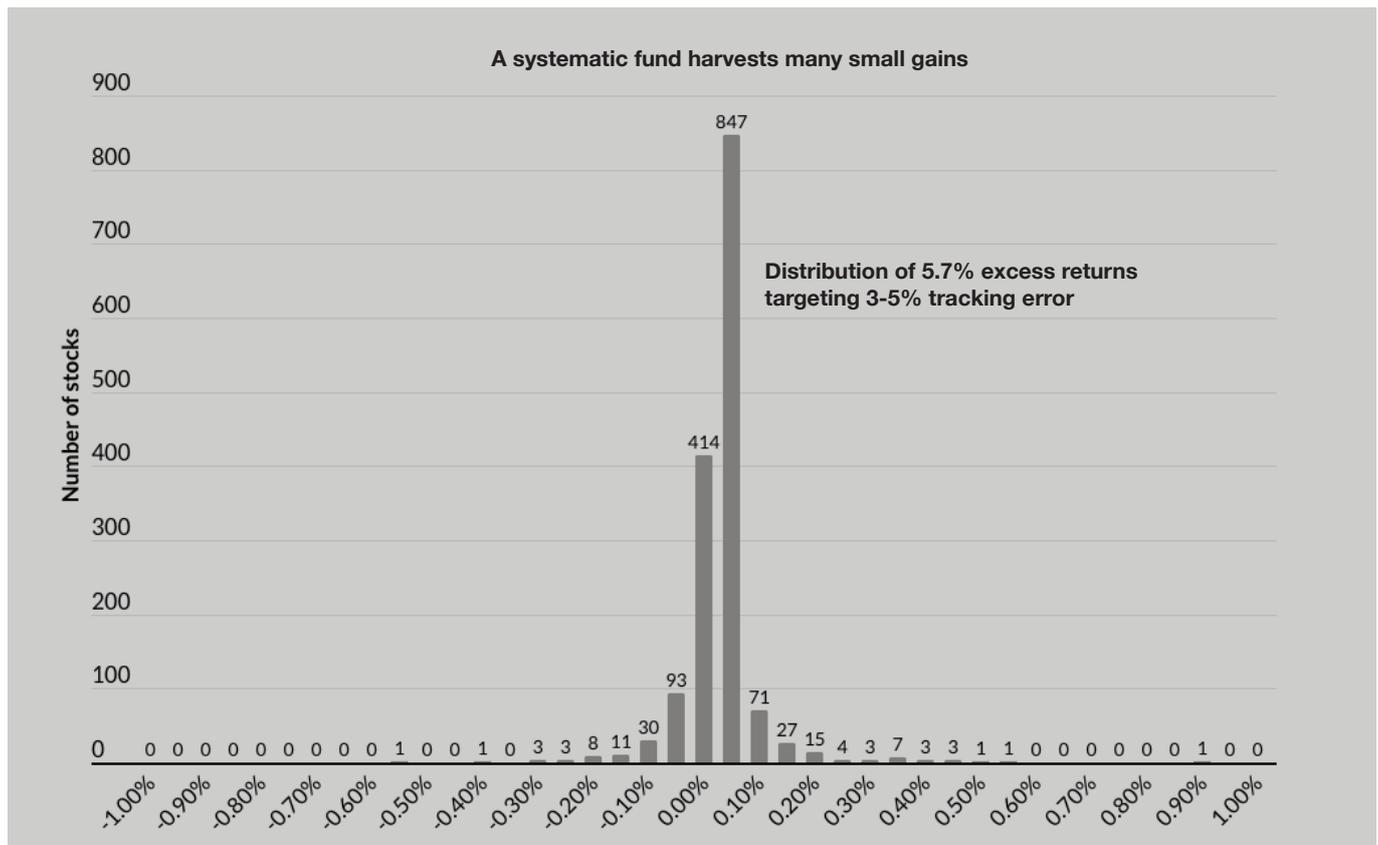


Notes

¹ The "Magnificent 7" refers to the companies Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla.

² Source: Mergence Investment Managers, FactSet, MSCI ³ Synonymous to quantitative investing ⁴ A term for systematic investment manager

Chart 2: Distribution of active returns of a systematic process 1 Jan 2024 to 30 Sep 2025



segments. The intention is to take only modest active bets on any given stock and deliver exposures to key characteristics that are associated with higher returns, rather than to take stock-specific risk.

Chart 2 illustrates the distribution of excess return (alpha) for a typical systematic process. It is representative of the actual risk and returns of the Mergence Global Quant Equity Portfolio that I have been managing since the start of 2024. The fund has delivered attractive and stable performance versus the MSCI World Index, outperforming the index by 5.7% since inception. While average contributions from stock winners and losers were characteristically small, attractive performance was achieved with the main body of the distribution that drove excess returns, rather than the extremes.

Regardless of which stocks become or stay magnificent, using a systematic investment approach has the potential to add excess returns in concentrated global markets.

NEW TOOLS IN THE INVESTMENT MANAGEMENT INDUSTRY

Advances in technology have brought new tools into the mainstream of the investment management industry. Systematic investment managers are both uniquely positioned to harness these innovations and less sensitive to future disruption across the investment management industry.

One such disrupter in investment management is the actively managed certificate (AMC). The Mergence Global Quant Equity Portfolio is an AMC, listed on the JSE and issued by UBS. Having managed global equity over many years in various fund structures, I appreciate how AMCs provide a faster, more flexible, and cost-efficient alternative to traditional investment fund structures. By securitising an actively managed investment strategy into a single tradeable certificate, AMCs streamline the process for both managers and investors, challenging established and traditional fund structures.

Other disrupters include machine learning techniques as alpha sig-

nal generators. While machine learning techniques are gaining popularity now, they have been around for much longer than most people realise. Innovations in natural language processing, data sourcing, and cloud computing have enabled more analysis than ever before, and sometimes, deeper insights. These advancements may or may not lead to more effective investment strategies.

It is important to remember that technology alone is unlikely to improve investment performance, and to beware of “AI marketing” hype. Ultimately, technology is a tool for productivity and supports people whose job it is to generate performance. As more companies compete for a technology advantage, paradoxically they will also need more talented and experienced individuals who can understand risk and can navigate through enormous data sets and make sense of what is truly useful.

Sense-making is a highly underappreciated skill, and crucial for navigating uncertainty in a world full of information and misinformation. Investing in human capital, ie: the skills that cannot easily be replicated by machines, is as important as investing in technology. Investment teams that invest in technology and merge a diverse set of skills are likely to be more successful.

Fazila joined Mergence in 2020 as portfolio manager in the multi-asset team. She has 20 years of experience in the financial services industry, and a passion for research, technology and sustainability. At Mergence, Fazila is responsible for developing quantitative and systematic strategies across global equity, balanced and absolute return funds. She has a BSc (Actuarial Science) and a PG Dip (Management in Actuarial Science).

