



Extended Mandates
Extended Equity Explained



FirstQuadrant

800 East Colorado Boulevard, Suite 900
Pasadena, California 91101

phone 626.795.8220 *fax* 626.396.3298
www.firstquadrant.com

Extended Mandates

Extended Equity Explained

Compared to the many recent advances in a wide variety of asset classes, innovation has been slow to come to traditional equity management. FQ's introduction of Extended Equity strategies builds upon our experience managing equities since 1990 and long-short strategies since 1991. Our work in Extended Equity offers new life to the asset class as well as the potential for enhanced risk-adjusted returns.

Extended Equity strategies can take literally hundreds of shapes and sizes. FQ already offers Global, International and S&P 500-based Extended Equity strategies, and that is just the beginning.

We address four basic questions in this piece:

1. What is Extended Equity?
2. How does it work?
3. When will it out or underperform long-only?
4. Should you consider an extended strategy?

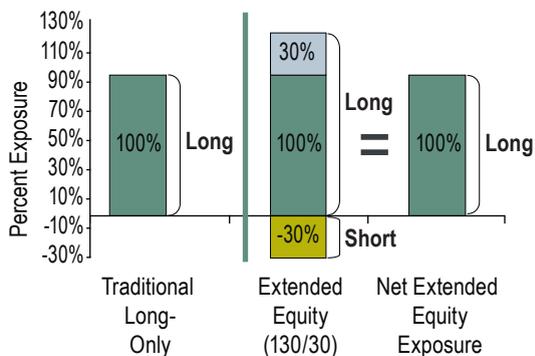
What is Extended Equity?

Extended Equity is a strategy that delivers 100% net market exposure while distributing active risk more efficiently than long-only strategies. The strategies invest long and short (e.g., 130% long/30% short) in a way that gives a manager more opportunity to find alpha with little additional risk.

How does it work?

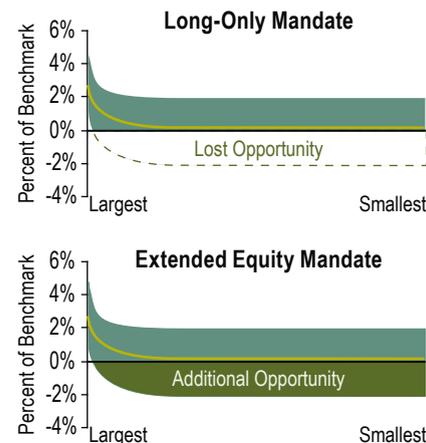
The objective of any successful strategy is to improve the information ratio (IR). Extended Equity strategies, when combined with a well-designed investment process – built to predict both outperformance as well as underperformance – can improve on typical long-only mandates because they:

- create a substantial increase in gross active exposure;
- distribute risk more evenly; and
- maximize the ability to short stocks and magnify underweight positions.



In traditional long-only strategies much of the information about underperforming stocks goes unused because small stocks can only be underweighted to a position of zero. This places an unnatural constraint and wastes a tremendous amount of information. By allowing active exposures on both the long and the short side, the strategy can spread risk across the

entire spectrum of stocks creating a more risk-efficient portfolio with more opportunity for alpha.



The chart shows the possible positions of each stock based on a constraint limiting all stocks to +/-2% of the benchmark.

When will it out or underperform long-only?

As long as a manager has skill in predicting both relative out and underperformance, Extended Equity can improve IR over long-only strategies. Our research in Extended Equity shows a doubling of information ratios over long-only mandates. Our conclusion – it does not require much aggressiveness to deliver a significant improvement in IR.

That isn't to say that Extended Strategies will outperform long-only mandates all of time. There are a few

circumstances in which an extended strategy may underperform. First and foremost, if a manager lacks skill in predicting underperformance as well as overperformance, this strategy will not improve IR. This requires an investment process to express an opinion about “all of the stocks all of the time,” not simply relying on a screening process to weed out or identify undesirable companies. We at First Quadrant do expect that over an entire business cycle our Extended Equity strategies will outperform similar long-only ones.

Should you consider an extended strategy?

The real answer is, it depends. If you are restricted from shorting equities or place tight constraints on your managers, it may not be for you. On the other hand, if you are looking for higher risk-adjusted returns, are open to new ideas, and can allow your managers freedom from some traditional constraints, you may want to consider FQ's Extended Equity strategies.

If you are interested in hearing more, please give us a call at (626) 795-8220.

FQ's available Extended Equity strategies:
US • Global • International