RELAXED CONSTRAINT

Understanding Relaxed Constraint Equity Strategies

February 3, 2017

In a prospectively low-return environment, the ability to generate active, above benchmark returns, has become even more important to meet performance hurdles. Relaxed Constraint ("RC") strategies (also popularly known as 130/30 strategies) are one solution that may interest equity investors.

RC portfolios are benchmark-relative strategies that allow a pre-determined fraction of shorts and seek to generate higher excess returns over comparable long-only strategies by taking more active risk. The two key benefits of RC over a comparable long-only portfolio are: 1) more flexibility for active stock selection which creates the potential for higher returns, and, 2) the potential for greater tax efficiency. From a portfolio perspective, RC strategies typically have net exposures of around one – that is, they move with equity markets, exhibit similar volatility, and therefore could be used in an equity allocation.

In this paper, we discuss in further detail how RC strategies work, some common misconceptions about the strategy especially relative to Long/Short equity strategies, and considerations in evaluating RC managers.

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