PARA BELLUM ADVISORS

EXECUTIVE BRIEF

Portable Alpha

What the Pitch Deck Leaves Out

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Executive Summary

Portable alpha separates market exposure (beta) from active return (alpha) and manages them independently. Use derivatives to hold the same equity market exposure cheaply, freeing capital to deploy into an uncorrelated strategy that generates additional return.

The pitch deck version looks like this: a $100 million portfolio uses index futures requiring only $6 million in margin to maintain $100 million of equity exposure. The remaining $94 million is split between an alpha strategy and a cash buffer. Result: full equity beta, plus alpha on top, plus cash yield. Marketed return in a bull market: 14.1%. Marketed protection in a drawdown: losses capped at -10.4% versus -15% passive.

> *The honest question at the outset: if this is so good, why is not every institutional portfolio running it? The answer is that the ones who tried it found out what the pitch deck omitted.*

Three Problems the Pitch Deck Does Not Price

PROBLEM 1	*Synthetic beta is not free. Futures and swaps embed financing costs, roll drag, and foregone dividend income. For Australian superannuation funds, franking credit leakage adds another 80-150bps annually. Most marketed examples omit all of this.*
PROBLEM 2	*The "uncorrelated alpha" most portable alpha structures rely on is not uncorrelated in the conditions that matter. QIS strategies, managed futures, market-neutral equity, and FX carry all share a common exposure: liquidity. When liquidity disappears, they correlate with equity. That is the only time investors need the diversification.*

PROBLEM 3	*Even genuine convexity, the only structurally uncorrelated alpha source, is useless without a pre-committed monetisation framework. A put worth five times its premium in a panic generates zero return if the committee hesitates while volatility mean-reverts. Most portable alpha structures have no monetisation framework at all.*

Once these three problems are properly accounted for, the real hurdle rate for the alpha leg rises to 250-400 basis points above cash before the structure breaks even with holding the physical benchmark. Most marketed implementations set that hurdle at zero.

Problem 1: The Real Cost of Beta Replication

Futures pricing is set by the no-arbitrage condition. A futures buyer does not receive dividends. Those dividends are embedded in the lower futures price, which means the buyer is implicitly financing the position at (risk-free rate minus dividend yield) per year. In current market conditions, that financing cost is roughly 0.4-0.5% per annum before anything else is added.

Add roll costs as contracts are renewed quarterly (20-40bps annually in normal markets, higher in stress), and for Australian superannuation funds, the franking credit income foregone by not holding physical equity. Franking credits are worth 80-150bps per year in after-tax value for a super fund in the accumulation phase. A derivative over the index does not carry them.

Cost Component	Annual drag vs holding physical ASX 200 ETF
Futures financing (SOFR/BBSW implied)	~45bps p.a.
Roll cost (quarterly bid-ask)	~20-40bps p.a.
Dividend leakage (not received via futures)	~120bps p.a.
Franking credit leakage (super funds only)	~80-150bps p.a.
TOTAL drag before alpha is generated	~265-355bps p.a. (super fund)

The alpha strategy must generate 265-355 basis points of net return before the structure breaks even with simply holding the physical index. Most pitch decks set this hurdle at zero.

> *Most marketed implementations set the hurdle at zero. It does not exist in the real world.*

Problem 2: Uncorrelated Is a Calm-Market Label

The strategies most commonly proposed as alpha sources in portable alpha structures are risk premia, not skill-based alpha. Managed futures, FX carry, market-neutral equity, low-volatility strategies, and most QIS products share a common underlying exposure: liquidity. They earn consistent returns in calm markets precisely because they are providing liquidity to other market participants in exchange for a premium.

In stress, that premium reverses. Liquidity disappears, correlations converge, and strategies that appeared independent draw down alongside equity. This is not bad luck. It is the predictable consequence of confusing liquidity-dependent factor premia with genuine uncorrelated return.

Strategy	Calm-market correlation	Stress-period correlation	What actually happens
Managed futures (CTA)	~0.05	~0.40–0.65	Trend-following reverses sharply in short crashes (Feb 2018, Mar 2020)
Market-neutral equity	~0.10	~0.50–0.70	Forced deleveraging hits both legs; prime brokers cut limits at the worst moment
FX carry (long AUD/EM)	~0.15	~0.75–0.90	Safe-haven flows crush high-yielding currencies; AUD/JPY fell 40% in 2008
Volatility selling	~0.05	~0.85–1.00	Mathematically equivalent to selling insurance against the exact event occurring
Long convexity (puts)	~−0.30	~−0.70	Structurally negative: value accelerates as markets fall, by instrument design

The only alpha source that is structurally, not statistically, uncorrelated with equity in stress is long convexity: instruments whose value increases and accelerates as conditions deteriorate. Everything else is correlation that merely has not been tested yet.

Problem 3: Convexity Without Monetisation Is an Accounting Entry

Assume the structure is built correctly: physical equity for the beta leg, genuine long convexity as the alpha source. A crisis arrives. The equity portfolio draws down 25%. The puts reprice sharply, generating perhaps 400% on the option premium. On paper, the structure is working exactly as intended.

Now what?

This is the question almost no portable alpha presentation addresses. A put worth five times its premium in the panic generates zero return if no one sells it. The monetisation must happen while the option carries its peak value. That window is typically 15–25 trading days into a drawdown. After that, policy interventions arrive, volatility mean-reverts, and the option bleeds value faster than the equity recovers.

Why committees hesitate

The arguments for waiting always feel rational in the moment. "The market could fall further." "Wait for policy clarity." "Hold the protection." These arguments are not wrong in isolation. But waiting for clarity is structurally incompatible with monetising convexity, because clarity and vol mean-reversion arrive together.

The family office case in the full paper is instructive. Their option book showed $18 million in unrealised gains at the peak. The committee met three times. No consensus to act. By the time they moved, they crystallised $5 million. The hedge had worked. The governance had not.

What a monetisation framework actually requires

1. Pre-committed trigger levels approved before the crisis, not during it. Portfolio drawdown thresholds (e.g. -8%, -12%, -18%) that automatically authorise tranche execution without a new committee vote.
2. Named individuals with execution authority. Not "the investment team." A specific person with a specific mandate.
3. Pre-agreed redeployment targets. The proceeds from monetised puts should buy something specific at a defined discount. That decision should be made when markets are calm.
4. Time limits on each tranche. Waiting for the perfect moment is not permitted.

Without these components, monetisation is discretionary. Discretionary decisions in a crisis are committee decisions under maximum uncertainty with maximum career risk. They will be delayed. When they finally happen, they will be suboptimal.

The Real Numbers: Five Years, Not One

Portable alpha pitch decks test the structure across a single year. The honest test runs across a full cycle. The following comparison uses three calm years, one moderate correction, and one severe drawdown.

Year	Passive ETF	Marketed portable alpha	Honest portable alpha
Year 1: +12% equity	+12.0%	+18.5% (QIS adds alpha)	+10.5% (convexity carry drag)
Year 2: +8% equity	+8.0%	+14.0%	+8.5%
Year 3: -12% equity	-12.0%	-6.5% (QIS partly correlates)	-3.5% (convexity partial payoff)
Year 4: +15% equity	+15.0%	+22.0%	+15.5%
Year 5: -28% equity	-28.0%	-27.0% (QIS collapses with equity)	+5.5% (convexity fully pays)
5-year cumulative	-10.3%	+10.4%	+35.2%
5-year annualised	-2.2% p.a.	+2.0% p.a.	+6.2% p.a.

The marketed version outperforms in every calm year. A governance body reviewing three-year rolling performance after years 1, 2, or 4 would see it winning by several hundred basis points. That pressure is how well-designed programmes get restructured at the worst possible time. The convexity budget gets cut just before the crisis that would have justified it.

> *The four things that determine whether portable alpha actually works: (1) The beta replication cost is stated and modelled, not assumed to be zero. (2) The alpha is structurally uncorrelated by instrument design, not historically uncorrelated. (3) The monetisation framework is pre-committed and board-approved before any crisis arrives. (4) The governance body understands that calm-market underperformance is the cost of real protection.*

Six Questions to Ask Before Any Capital Is Committed

These questions should produce clear, direct, quantified answers. Vague responses are informative.

Question	What a good answer looks like
What is the all-in annual cost of beta replication, including financing, roll costs, and foregone dividend and franking income? Show the calculation.	A specific basis point number. Not a footnote assumption. If they cannot give a number, they have not done the work.
What was the realised correlation of the alpha strategy during March 2020, October 2022, and Q4 2018? Show monthly returns, not the full-period average.	A data series. If they cannot provide it, they do not know how the strategy behaves when it matters.
Is the alpha source a factor premia strategy? If so, what is the mechanism by which it stays uncorrelated when liquidity disappears?	A structural mechanism grounded in instrument design. "Low correlation in our back-test" is not an answer.
If the alpha leg uses options or convex instruments, what is the monetisation framework? Who has authority to act? Where is this written down?	A specific written protocol with trigger levels and named individuals. If it is not written down, it does not exist.
What is the break-even alpha required, after all costs, for this structure to outperform simply holding the physical benchmark?	A basis point number included in the proposal. If it is not there, demand it before proceeding.
What happened to similar implementations during the stress episodes listed above? Not the back-test. The live performance.	Live data. If it does not exist, ask why not, and what that implies about the track record being presented.

What a Version That Actually Works Looks Like

The following table compares the standard pitch deck version with an implementation that can genuinely deliver on its stated purpose. The honest version is more expensive in calm markets. That is not a flaw. It is the cost of protection that actually functions.

Element	Pitch deck version	Honest working version
Beta leg	Futures at 6% margin; no cost discussion	Physical equity for domestic allocations. Futures only for non-domestic where franking does not apply.
Financing cost	Omitted	Explicitly modelled and stated as annual drag before the alpha hurdle is set.
Alpha source	Managed futures, market-neutral, QIS carry	Long convexity: rolling out-of-the-money puts with genuine positive payoff in sharp drawdowns.
Correlation assumption	Historical 0.05-0.15	Structurally negative by instrument design. Not an estimate from calm-market history.

Alpha carry cost	Presented as return-positive in all periods	Explicitly budgeted at 100-200bps annually. Accepted as the cost of genuine protection.
Hurdle rate	Implicitly zero	250-400bps above cash, stated and stress-tested before capital is committed.
Monetisation	Not mentioned	Pre-committed board-approved tranche triggers. No committee discretion during drawdowns.
Governance	IC presentation with scenarios	Daily hedge P&L monitoring, drawdown playbook approved before deployment.

About This Brief

This Executive Brief is a companion to the Para Bellum Advisors practitioner paper: Portable Alpha, What Survives Once You Remove the Marketing. The full paper covers each of these issues in detail with worked examples, case studies, implementation checklists, and appendices covering futures pricing mechanics and the franking credit calculation.

Available at **www.parabellumadvisors.com/practitioner-papers/portable-alpha-what-survives-once-you-remove-the-marketing/**

About Para Bellum Advisors

Para Bellum Advisors is an independent advisory firm specialising in derivatives, structured finance, and balance sheet efficiency for institutional investors, family offices, and corporate treasury teams.

The firm focuses on hedge framework design, overlay mechanics, collateral efficiency, and portfolio resilience across FX, rates, credit, equity, and volatility exposures. Its work is practitioner-led, drawing on three decades of experience across trading, structuring, and portfolio management in APAC and globally.

Para Bellum Advisors is independent of product distribution and transaction mandates. Its objective is durable improvement in capital efficiency and liquidity resilience.

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