Quant Hedge Funds Rise in Falling Markets

FINalternatives

Quantitative hedge funds that were posting miserly returns just last summer are now taking it to the market. These funds are trouncing their fellow hedge funds and the broader markets, and some are on pace for their best year ever.

Lonny Bernath, principal of Charlotte, NC-based Headline Investment Management, has had a lot of success this year trading his US$23 million Headline Group Fund, which employs four strategies: a pair of equities strategies, a futures exchange-traded fund strategy and a currency strategy. Bernath said all of the strategies adopt rules-based modelling and none of them are correlated to each other.

"Most quant funds will start with a mathematical formula and work their way into a trade," he said. "We start with a logical idea that we think will work in any market and we use numbers and modelling to back up that idea. That logic has really held up well even in these markets."

So far, the fund's logic has held water in an increasingly tough market for hedge funds. Headline is up 22% this year through October. "Our best performing trades have been our equities trades and we've made money on both sides this year," said Bernath. "Our equities strategies are built around earnings, so during earnings season we heavily invest on the equities side and when we roll out of earnings season we roll our book into the currency trade a little more."

Bernath is looking to add Standard & Poor's 500 futures and commodities trades to the fund's portfolio.

A Geneva-based adviser is also distinguishing itself from its peers. The Princes Gate Group's Systematic Managed Futures programme rose 4.2% in October and is up 29.2% year-to-date. The US$60 million fund, which recently opened to external investors, is a systematic long/short strategy that trades foreign exchange, interest rates, commodities and equity indices.

"Our goal is not to forecast market direction but to identify the trends through signals and adapt to them," founder and portfolio manager Paolo Faldini said. "Consequently, the strategies that we designed are not aiming at extremely high double-digit yielding but to control risk and maintain it within reasonable levels so that we always provide our clients with solid and stable returns."

Faldini added that the good times are continuing this month for the fund, which is up a couple of percent points so far in November.

More established firms such as Hyman Beck & Co are also posting outsized returns. The firm's US$428 million Global Portfolio posted an estimated 16% gain last month bringing its year-to-date returns to a chest bumping 46.52%.

Hyman Beck said continued turbulence in the financial markets provided ideal conditions for its quantitative directional strategy, which recorded its second best monthly performance since its inception in April 1991.

The firm admitted that directional strategies tend to exhibit a higher volatility in their returns when compared to other strategies.

"However, this same strategy has allowed the Global Portfolio to record new highs in NAV throughout its 17-year history," it said. "The ability of the portfolio to be either long or short instruments as the markets dictate, enables Global to provide insurance against long-only strategies."

Headline's Bernath concurs with the firm's assessment. "Certain types of trades such as momentum-type trades are working well so the quant funds that specialise in them are doing well. There's always going to be strategies that work well in any environment," he said.

And the venerable John W Henry & Co reported "exceptionally strong" performances in October stating that four of its programmes produced gains of between 16% and 32% for the month. Its GlobalAnalytics, Diversified Plus, International FX Program, and Financial and Metals Portfolios are up 72.35%, 32.45%, 68.86% and 29.50%, respectively, year-to-date.

JWH's president Kenneth Webster said the firm has never looked to sell its way of investing as the only way but have focused on educating its existing and potential investors about the benefits of systematic trend following strategies. "It is estimated that as many as 50% of the current hedge funds in existence will go under from the effects of this current crisis," wrote Webster, in a letter to investors.

"Many of their strategies will come under pressure; some observers forecast that they will no longer provide future benefit regardless of their performance history. The statement will be made, as it always is during times of stress and uncertainty that 'this time the world has really changed'. Many investment managers will react and try to reinvent themselves in light of their own predictions for the future."

JWH, which once managed more than US$1 billion before falling on rough times, has quietly re-grown its assets under management to US$326 million.

This article first appeared in www.finalternatives.com on 18 November 2008.