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For Man Systematic Strategies' Sandy Rattray the key is 'do lots more different things'

By *mkitchen*
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"Each of our funds is a niche product where we're trying to resolve a specific issue that investors face," notes Sandy Rattray, the CIO of Man Systematic Strategies (Man SS), as he outlines the business structure of Man Group's newest division. Man SS launched in November 2010. Its current team, headed up by Rattray, totals 16 people.

Leveraging the support of other systematic managers within the Group – namely AHL, GLG and Man's Multi-Manager business – Man SS has already raised over USD1.6billion in AUM for three funds spanning equities, commodities and tail risk; plans for a fourth fund in the fixed income space are already afoot.

This is an encouraging start for the firm, but Rattray is well aware of the problems that quant funds have had in the past and certainly doesn't harbour allusions of grandeur: the modus operandi here is not to become a behemoth quant firm employing hundreds of professionals and running over-inflated fund products. In their heyday of 2006, US quant equity managers managed close to USD1trillion. The quant crisis then hit in 2007, causing these financial engineers to lose almost 60 per cent of their assets in what was to become an unedifying period of four years of negative performance. The problem, as Rattray recounts, was that all the main players were doing fairly similar things.

"The people at each of the major quant equity firms thought they were different but in reality they bought data and risk models from the same places and hired people from the same places (like the University of Chicago's finance department)," says Rattray.

"The real response is to do lots more different things. That means many of those things will actually be a lot more capacity-constrained than people initially thought in quant equity strategies."

Indeed, by way of an extreme example to illustrate the point, Rattray recounts that a few years ago when he was looking to buy a quant fund for Man in order to break into the short-term quant trading space he called a former Goldman Sachs colleague who'd started his own business. The fund itself was running USD5million, it was posting impressive returns, but the former colleague politely rejected Rattray's overtures because he genuinely didn't think the fund had any further room to grow.

The lesson from '07 seems clear: quant equity strategies are not capable of being scalable to the same size that people first thought.

Today, there are multiple quant strategies for managers like Man SS to choose from. They range from equity statistical arbitrage and quant macro to market sentiment strategies and credit arbitrage. Currently, the Man SS strategy spans five separate strategies: equity alpha capture, systematic commodities, behavioural finance strategies, fixed income trading and tail protection.

To reinforce the fact that Man SS is focused on developing a successful range of capacity-constrained products, Rattray comments: "Our largest strategy today – Man GLG Europe Plus – probably has a capacity of USD5-10billion. The fixed income strategy that we've yet to launch will, we think, have a capacity of USD750million."

Man SS uses one single technology structure to run all of its strategies. Trade and risk management is implemented through GLG. Unlike other quant firms, Man SS is able to draw upon relationships with GLG and AHL; one of the industry's leading CTAs founded back in 1987. It also has the Oxford Man Institute, which the parent firm sponsors, and by way of further reinforcing its academic ties, Man SS works closely with Campbell Harvey, a US academic and editor of the prestigious Journal of Finance.

It's first fund, TailProtect, grew out of a recognition at Man that hedge funds occasionally exhibit large negative returns: think May 2010, and Aug/Sep 2011. As its name suggests, TailProtect invests in volatility. Said Rattray: "We wanted to build a fund that would reliably make lots of money during stress periods and not lose too much during benign periods." The problem with hedging against volatility is that it's expensive. Anyone can buy a put option on the S&P 500 and wait for market turmoil, but any gains you make tend to get wiped out when the markets are behaving normally.

The challenge with volatility products, therefore, is how to make money during dislocations without reducing costs so much the rest of the time that it actually jeopardises the reliability of the strategy in stress periods.

TailProtect works by actively investing in long only equity volatility via two complementary strategies: Spike Detection Strategy and Forward Volatility Strategy. The model aims to minimise carry costs and maximise performance during spikes in volatility.

"We didn't want to build a fund that was passive on volatility like buying futures so we developed a spike detection strategy which uses high-end mathematics to detect when crises are about to blow up," explains Rattray. When short-term volatility spikes are detected the strategy buys long equity variance swaps. These derivatives are essentially option-based products that allow investors to take a view on future volatility.

This dynamic strategy accounts for 40 per cent of the strategy's risk allocation. The other 60 per cent derives from the forward volatility strategy which involves buying implied volatility. "The fund returned 26 per cent last year, this year it's down 3 per cent. We think we've built something that can reliably make money in stress periods and minimise carry costs. The capacity of this fund is around USD1billion," added Rattray, noting that the fund is currently running at about half capacity.

The firm's equity fund – Man GLG Europe Plus – uses the best 'buy' recommendation ideas from brokerages. Rather than relying on analysts themselves, Man SS uses sales executives in 65 brokerages to cherry pick the best ideas. Totalling roughly 1,0000 ideas, on average, these are fed by the brokers into a website that GLG Partners has been running for the last five years.

"What we discovered was that in Europe broker ideas are a remarkably reliable source of alpha. From these buy ideas you can get about 1.7 per cent alpha," says Rattray. The trick here is to act quickly on the recommendations. Man SS discovered that the level of outperformance plateaus after 50 to 60 days. The fund therefore invests quickly and gets out quickly in order to capture the alpha with Rattray pointing out that "if you hold for 12 to 18 months you're really just sitting on dead money". TCA is vital in such a strategy; trading costs have to be kept to a minimum so as not to erode the alpha component.

Last January the strategy was extended into an index product, launching with ETF provider Source as Man GLG Europe Plus Source ETF. Net assets since inception have ballooned to approximately USD1.2billion making it Source's largest equity ETF. Already in 2012, the Man GLG Europe Plus Index is up 11.73 per cent.

As for the Man Commodities Fund, which launched in March 2012, its key alpha signals are based on three sources: trend-following signals (40 per cent), carry signals (40 per cent) and fundamental signals (20 per cent). Obviously, the fact that AHL has over 20 years' experience running a CTA strategy gives Rattray's team some level of support but the two strategies are completely separate and do not share trading ideas or algorithms.

Like TailProtect, it's a long-only product and to avoid the scary drawdowns that commodity funds can often produce the fund is not always fully invested. "We run something that's fairly dynamic in terms of how it invests in commodities: it's often 70-100 per cent invested. When we think commodities are going to fall we'll actively scale down our positions," says Rattray.

Knowing the limitations of strategies is helping Rattray, who sees great opportunities in the overall quant space, build Man SS into a formidable business.

"We've raised a lot of assets in a short period of time and delivered decent performance on those assets. As the strategies are capacity limited we're going to run them with smaller teams. When they reach their limits we'll simply go and build new strategies as opposed to making them bigger," says Rattray.

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