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Quant Hedge Fund Rebound Not Enough To Stem Big Losses

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SAN FRANCISCO (Dow Jones) -- Some of the largest so-called quantitative hedge funds suffered big losses in August as a rebound later in the month eluded several managers.

Goldman Sachs' (GS) largest hedge fund, the $8.5 billion Global Alpha fund, lost 22.5% last month, leaving it down 33% so far this year.

A big statistical arbitrage fund run by J.P. Morgan's (JPM) Highbridge Capital hedge fund business lost roughly 18% in August, according to two investors who didn't want to be identified.

The $3 billion Tewksbury Investment Fund, a computer-driven statistical hedge fund, lost 8% last month. Black Mesa Capital, another quantitative hedge fund, ended August down 10.7%, according to an update an investor in the fund sent to clients.

Quantitative, or "quant," hedge funds use computer models to generate trading ideas. Some use a market-neutral approach, which aims to balance long positions with short trades, or bets against securities. Others are so-called statistical arbitrage funds, which analyze historical relationships between related securities and trade when those relationships get out of whack.

Many of these funds were hit hard in early August as forced selling by some managers disrupted such historical relationships. That handed more losses to other hedge funds in the space. Those using lots of borrowed money to magnify returns had to reduce that leverage by unwinding positions. That may have triggered a chain reaction.

Once such turmoil subsided, there was a rebound as related securities returned to trade closer to their historical pattern. That helped some quants recover losses. But others, who were either forced or decided to de-leverage, missed most of the rebound.

"To benefit it was critical that you hadn't de-leveraged too much," said Marco Battaglia, chief investment officer of Temujin Fund Management, a market-neutral hedge fund with more than $1 billion in assets. "Some managers were able to benefit from the rebound, but most obviously didn't make it all back."

Temujin uses both quantitative and fundamental analysis to generate trading ideas. The fund was down roughly 4% at one point in August, but recovered most of those losses to end the month down 0.4%, according to a person familiar with the firms' performance. It's up about 8% this year, through the end of August. Battaglia wouldn't discuss returns.

Renaissance rebounds

The Renaissance Institutional Equities Fund (RIEF), a giant quant fund that's designed to manage up to $100 billion in assets, was one of the few in the space to end August in positive territory, climbing roughly 0.4%, according to two investors who didn't want to be identified.

RIEF was down almost 9% in early August, James Simons, head of Renaissance Capital, wrote in a letter to investors last month. Still, Simons told clients at the time that the firm planned to hold out in the hope of regaining some of those losses.

"Our basic plan is to stay the course and, as conditions revert to the norm, we anticipate the possibility of an attractive opportunity for RIEF," Simons wrote.

The 32 Capital Fund, a $2 billion statistical arbitrage hedge fund run by Barclays Global Investors, also ended August in positive territory, eking out a 0.24% gain. Performance earlier in August had been "challenging," The Wall Street Journal reported.

But a BGI spokesman said in early August that the fund was "maintaining risk levels" and that managers felt their portfolios were "positioned appropriately."

Goldman's Global Equity Opportunities (GEO) quant hedge fund lost roughly 30% in early August. Sensing a rebound was possible, the firm pumped $2 billion of its own money into the fund soon after the losses. It also got outside investors, including former American International Group (AIG) Chief Executive Hank Greenberg, to pitch in $1 billion more.

GEO reportedly rebounded after the new investments. That potentially generated a gain of roughly $150 million for Goldman, according to an estimate by Sandler O'Neill analyst Jeff Harte.

Global Alpha

Still, Goldman didn't invest any money in its larger Global Alpha quant fund, which ended August down 22.5% and off 33% year-to-date.

Global Alpha's market-neutral strategy lost 4.7% in August, leaving it down 10.7% so far this year, the fund wrote in a letter to investors.

"While we saw some recovery in the U.S. equity market neutral strategy, we still ended the month significantly down in that strategy," the fund explained.

Global Alpha also said it did "moderate" its positions and is focused on making sure it has a "substantial" amount of its portfolio in cash or easily tradable securities.

The Highbridge Statistical Opportunities Fund, which uses a leveraged equity market-neutral strategy, lost about 18% in August, according to two investors who spoke on condition of anonymity. That was roughly in line with losses the fund suffered during the first week of that month.

"The ones that got really hurt were the equity market neutral funds," said Russ Lundeberg, chief investment officer of Barrett Capital Management, which invests in hedge funds and other assets on behalf of wealthy families.

"The real separation came as some funds were forced to sell into the draw-down and de-lever," he added. "So when these funds saw a rebound in the market, they didn't recover as much."

"These types of draw-downs will occur in this area," Lundeberg explained. "But if the fund is able to hold on, historically they've always been able to rebound."

Black Mesa

Black Mesa, a quantitative market neutral fund run by David DeMers and Jonathan Spring, lost 10.7% in

August. The firm told investors on Aug. 8 that it was down about 7.5%.

The firm lost as much as 13% during August, but reduced its leverage and sold positions to raise cash, possibly avoiding bigger losses.

As of Aug. 8, the firm said it had between 50% and 100% of its portfolio in cash and had brought leverage down to 0.5 to 0 times its assets, according a letter it sent to clients, a copy of which was obtained by MarketWatch.

However, that damage control may have meant that Black Mesa missed out on some of the rebound later in August, leaving the firm with its 10.7% loss last month. DeMers declined to comment on Thursday.

Other quant funds also lost money in August.

The Tewksbury Investment Fund, run by Matthew Tewksbury, ended the month down 8%, an unusually large loss from a firm that has generated steady returns that have averaged more than 14% since inception.

A $600 million fund run by James Claus' GMN Capital lost more than 19% last month. The ACI U.S. Market Neutral Fund, run by Algert Coldiron Investors, was down more than 19% through Aug. 24.

Quant future

In future, quant hedge funds will probably operate with less leverage, or borrowed money, Temujin's Battaglia said.

That's a big change, he added. Until now, market-neutral funds often traded with leverage of between 300% and 1000%, he noted.

Managers will also try to identify and develop new variables in the markets that can help them generate future gains and avoid big losses, Battaglia added.

"Managers are realizing that their assumptions about what could go wrong were not correct," he said. "They'll now attempt to explore new effects, other than the ones that they've been trying to harvest over the past five to ten years. That's down the road and it's not clear if they'll be successful in achieving that."