AsiaHedge
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Singapore

A hedge fund market blossoms

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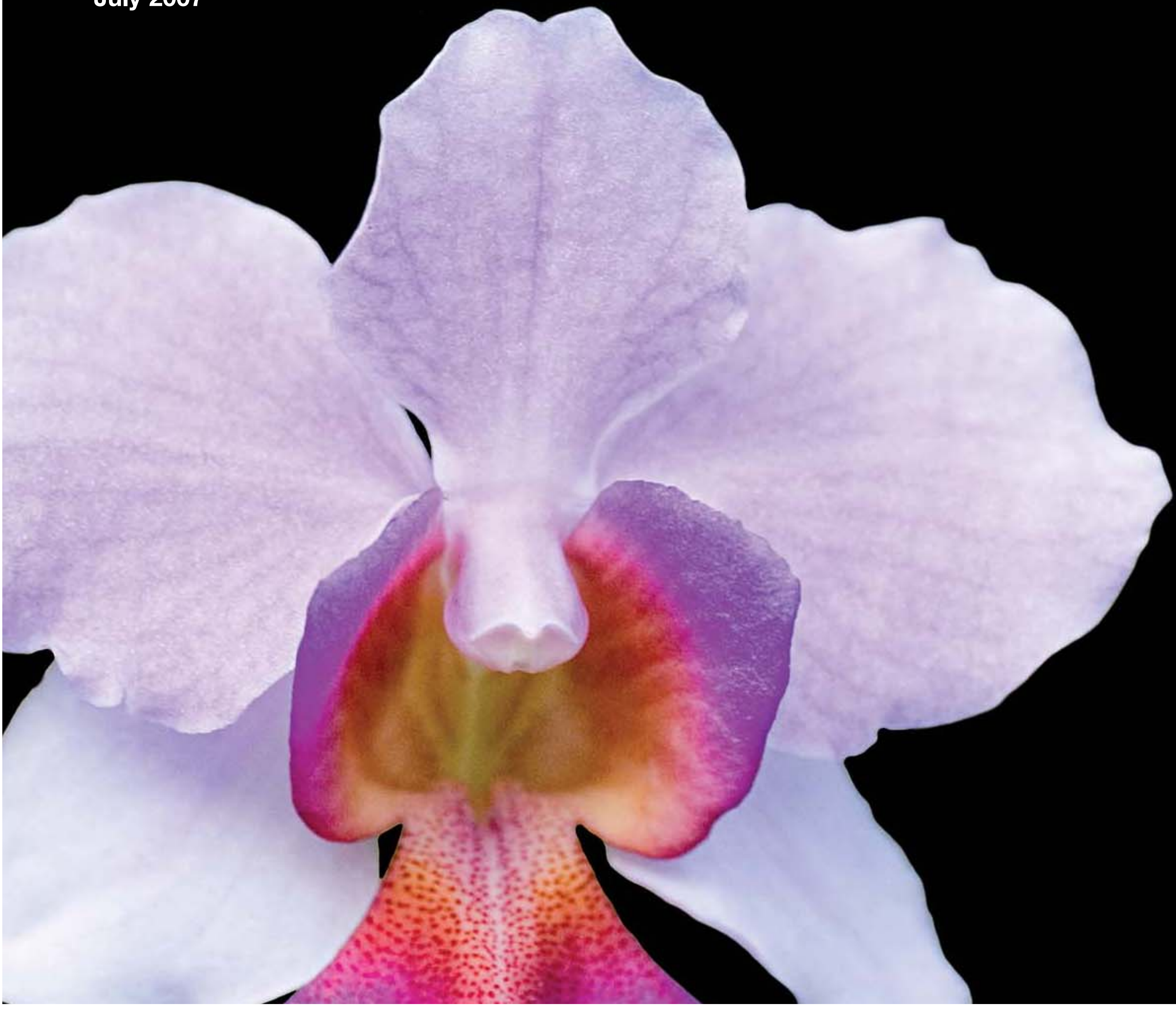

may not go for a young fund in Singapore," says Strover. "The bigger mistake was that, by pursuing that product, we failed to try something that played to our strengths."

He describes the paring down of assets under management as "a relief", because it enabled him and co-founder Paul Cuthbert-Brown to rethink and go back to basics.

Throughout that period, the stock-picking process remained the same, but portfolio construction changed. Whereas previously a high conviction position may have accounted for a maximum 5% of the portfolio, now it can be as much as 40% and the portfolio has gone from 100 to fewer than 20 positions.

"Paul understood that the purpose of risk management was not to take less risk, but to take more of the kind of risk we wanted to take," says Strover.

"Previously, we hedged out a lot of the risk. Now we are assuming more idiosyncratic risk and less market risk and I can now spend my time on a few companies I think are really great."

This enables Strover to get to know management well. Although the fund has no activist agenda, friendly or otherwise, this in-depth approach means Strover is sometimes seen as an educated resource and sounding board by management, and therefore he can put corporate announcements and changes in a better context than previously.

At the third anniversary mark, the fund has shaped up to be one of the best performers in its universe, with 100%-plus gains since inception and over 28% compound annualised return. Strover simply attributes this to good stockpicking and a concentrated portfolio. Performance has raised the assets under management, which are now nudging the $10 million mark.

"In June, the fund was up 13.4% and was invested in 15 positions, all but a handful of which made money for the fund. Of the losers, we took the opportunity to add to two of them," explains Strover.

Strover and Cuthbert-Brown never had any doubt that the decision to locate operations in Singapore was the right one. Strover travels widely throughout the region, and an efficient airport that is a short cab ride from the office is a godsend, as is the fact that its common law is in English.

"Singapore is also clean and green, and has a family environment that is not to be underestimated," he adds.

Octagon Capital

For Octagon Capital's Lam Poh Min, there was no decision to be taken about the right location. "My partner, Nelson, and I are both Singapore born and bred – that's why we're here," he says. "Singapore has been good to us, especially on the regulatory front and it was really the only practical choice when we started out with limited resources and AUM of less than $1 million."

The Octagon Pan Asia Fund is a long/short Asia including Japan equity quant fund and reflects Lam's background, including nine years with the Government of Singapore Investment group, where he was senior portfolio manager in the Quantitative Investment Unit. "Quant investing is the only thing I know and you've got to focus on your circle of competence," says Lam.

"Also, three years ago when we started, it's fair to say quant was pretty much non-existent in Singapore and we felt there was a strong void that needed to be filled and we were able to do it." It took a while to demonstrate to investors, but 12 to 18 months after inception, the fund took off. Now, with $300 million in assets, it has already been closed for almost a year.

Unlike other funds, the Octagon Pan Asia Fund does not take into account any fundamental characteristics and the strategy's technical, statistical approach is based purely on price and volume, creating a systematic approach to technical trading. The model analyses and interprets stock price trends, so the fund goes long on the up-trend and short on the down-trend across 14 markets in the Asia including Japan universe.

"The portfolio tracks the best trends in Asia with no sector, market capitalisation or geographical biases, other than those imposed from a risk management standpoint," says Lam. "The model drives us towards the best opportunities across Asia and allocates risk capital until such times as risk capital parameters are reached."

The fund is now very aggressively positioned in Taiwan, Thailand, Pakistan and Korea. It is not designed to be market neutral but opportunistically directional. "It can go long or short

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according to market conditions and quant parameters. The average long bias over the past three years reflects the bull market conditions, but it has by no means been very long, only 40% on average, which is modest compared with other Asian managers," says Lam.

Because the model includes a number of emerging markets, such as Vietnam and Pakistan, the fund also has scope for qualitative judgement when it comes to implementation. "In exotic markets and in shorting individual stocks, typically we need to use some discretion," says Lam.

For example, the model may recommend shorting a stock for which there is limited stock borrow. "It's not always so straightforward, so the qualitative input is an important and necessary complement to the model, not to override it," says Lam. In short, the model helps to answer the questions of what to buy and sell, while the qualitative overlay helps decide how and when to buy and sell.

In addition, there is the Octagon Tactical Short Fund, a short-only fund with a portfolio that is a clone of the Octagon Pan Asia Fund short book. Launched in October 2006 with $5 million, the fund now has $14 million in assets and a capacity of $100 million to $200 million, based on liquidity assumptions in a bear, not bull, market and factoring shorting limitations.

"We want to be able to trade in a bear market," says Lam. "The rationale of the fund reflects our philosophy of going where others do not go. Long-bias long/short equity funds are very common in Asia, but, as the market matures, people will be looking to counterbalance their long-only portfolio and there is a gross shortage of such expertise and strategies in the market."

The flagship fund has produced some of the best risk-adjusted returns around and a lot of that performance can be attributed to the tactical use of shorts. The model continues to point to bullish conditions, but Lam believes that a short-only fund cannot be launched when the market is down and that it pays to be early.

Quant Asset Management

Also pursuing a quant strategy from Singapore is Quant Asset Management, which had $139 million in assets at the end of June 2007, comprising $88 million in the QAM Global Equities Fund and $51 million in the QAM Asian Equities Fund.

"The unique feature of our funds is that we leave everything to the model," explains QAM's co-founder, Frank Holle, who set QAM with Chatchai Ngampakdeepanich in 2004. "The QAM quant model has its own artificial intelligence; it detects movements in an enormous amount of data from 52 countries worldwide very fast and converts that into investment decisions that result in a portfolio of around 120 stocks. Our investors need to know that we are entirely consistent. If there's a human overlay, your consistency is out of the door and, on top of that, you have no option of back-testing."

The years of back testing that the model enabled them to do means that they have a very clear idea of the kind of returns and volatility they can expect. The model is based on a dynamic blend of 20 to 30 factors according to several underlying convictions – that share prices are driven by earnings expectations and relative valuations, and that markets are at best semi-efficient. The balance between longs and shorts is also model-driven and the factors are rebalanced by the model on a monthly basis.

"Because we rebalance only once a month, if something happens within that month we don't react, we wait, and over the long term we are always exposed to the market in order to fully milk the track we're on," says Holle.

Since launch, both funds have performed according to expectations – as of the end of June 2007, the global fund was up 30% year-to-date and had an annualised compound return of 30.5%, while the Asia fund was up 40% year-to-date and had an annualised compound return of 29.8%. Volatility for the two funds has so far ranged between 16% and 19%.

With such target returns and volatility, neither fund could be considered conservative. "That's deliberate," says Holle. "But with these kinds of returns and the consistency in our approach, investors will be very happy to leave the management of their fund to a computer."

While quant funds are one example of the breadth of Singapore's hedge funds industry, the bulk of managers are still clustered in the long/short equity space. In this space, several managers illustrate the continued blurring of the line between hedge funds and private equity.

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