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Aspect's Anthony Todd says the trend is your friend

The rise of systematic trading hedge funds are often blamed when markets misbehave. **Bloomberg**

by Jonathan Shapiro

Volatility is rising. Stocks and bonds are getting sold off and poor old investors are losing money.

And it's all the fault of those villainous computer driven hedge funds?

As markets have convulsed, Commodity Trading Advisors (CTAs) and quantitative hedge funds that trade on market trends are once again being singled out for amplifying market moves.

But Anthony Todd, the chief executive of $US6.7 billion London based quantitative hedge fund Aspect Capital says those that point the finger at his and other funds for exaggerating market moves showed a "lack of understanding" about how they work.

"[At the beginning of the year] we were getting calls from journalists who were told we were catalysing this collapse in stock markets," said Mr Todd.

Todd said that the way Aspects models worked meant it had short positions in stock and commodity markets before the January sell off and that increases in market volatility lead them to scale back their trades.

"We were actually buying back our positions. We were providing liquidity to the market and closing off our positions."

"Trend-following" or "momentum" hedge funds use systematic trading strategies to profit from developing trends in major markets, based on the belief that prices have a

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As trend following hedge funds have grown in size, some commentators have suggested that they are crowding each other out as they deploy similar strategies.

Again, Todd rejects this assertion. By his numbers there is about $300 billion allocated to CTAs representing about 10 per cent of the entire hedge fund sector.

Aspect, he says, has modelled the entire 'foot-print' of trend following funds by aggregating similar funds. When that sum is super-imposed on the vastness of the 100 largest and most liquid markets, their impact is "insignificant."

"We are a long way from over-crowding," he says.

Mr Todd says trends exist and will continue to exist in markets because investors tend to herd. Also investors respond at different speeds to information while others are so large that it takes them weeks or month to undertake a portfolio reallocation.

These strategies have grown in popularity among the world's largest investors that have become more convinced by long-term performance studies and academic papers that momentum is a persistent, centuries old feature of markets, and therefore a source of reliable returns.

"Three or four years ago, we very much had to sell medium-term trend following and convince investors that this was an important source of diversification," says Todd.

"Now walking into client meetings we hardly ever have a discussion around why trend following works – the battle has been won," he says.

Along with Winton and quantitative hedge fund pioneer AHL, which is now owned by the Man Group, Aspect is one of the three largest and best known trend following hedge funds.

Todd's partner Martin Lueck is the L in AHL, while David Harding, the founder of CTA giant Winton is the H.

The firm employs 128 staff in London of which around 80 are in research function.

Todd and Lueck are both Oxford physics graduates and maintain a scientific "hypothesis-based" approach to analysing markets.

"We are cautious about the approach of throwing a huge amount of data at powerful computers and seeing what the results are."

"The genesis of any idea, has to be a hypothesis about market behaviour."

The fund was created in 1997 and while its broad strategy of identifying and profiting from medium term market trends is unchanged, the models have become increasingly sophisticated.

"If we were running the same programme today that we ran 20 years ago we wouldn't have a business. It's the same principal of systematic medium term trend following, but the models have come on enormously."

"Our view is that markets evolve over time. That the space we operate in is becoming more competitive and its critical to evolve our models to refine them and add to them to protect the source of return."

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