

Interview: Oliver Prock - Salus Alpha

Stockholm (HedgeNordic) - Founded in 2001, Swiss based Salus Alpha was an early adopter in terms of offering hedge funds in a UCITS compliant format. Thanks to their UCITS wrappers, Salus was brought into the Swedish premium pension system PPM in 2009 as one of only a very few hedge fund companies. The company's flagship strategy, Salus Alpha Directional Markets (DMX), is a Managed Futures strategy that has been trading live since 2003 with highly competitive performance numbers for its niche. HedgeNordic took the opportunity to let Oliver Prock, the founder of Salus Alpha explain the strategy in more detail. And here is what he had to say:

HedgeNordic: What is the current AuM of the strategy, how much is in the fund/managed accounts? What is the split between institutional and retail investments?

Oliver Prock: We currently have a strategy AUM of \$250million of which around \$50million is in the UCITS fund. The balance is split between single managed accounts and investors who have come in via the DB Select platform. We are pretty evenly split between institutional and retail investors although we are proud of the infrastructure that we have in place that has been found more than satisfactory by the most sophisticated institutional investors. In addition, our regulated UCITS fund continues to pave the way in the face of ever tightening regulation in the CTA space.

HedgeNordic: What fees are charged on the fund level? (If differences in fees charged for different share classes kindly mention these)

Oliver Prock: Our fee structure is very simple. For single managed account investors and investors via DB Select they are 1.25/20. Fees for investors into the UCITS fund are 2.25%.

The DMX strategy is described as "adaptive" going from trend to countertrend and short-term to more longer term depending on your forecasting. In what periods do you expect the strategy to over/underperform a more traditional trend following strategy?

Being "adaptive" means that we have demonstrated over our 11 year track record that we outperform a traditional trend follower in almost every market environment. 2008 was a great year for most traditional trend followers, as it was for us and we returned 63% net to our investors. In 2009 when most trend followers gave back a large portion of their returns earned in 2008, we ended the year again in positive territory, thereby demonstrating how we successfully protect capital during periods that are otherwise unfavourable to traditional trend followers. This we would say would be an important differentiator between how we behave and how most other CTAs behave. A traditional trend follower looks for trends and it is then that it makes its returns. When there are no trends it will often lose money, hoping to make up these losses when trends return. Directional Markets on the other hand also enjoys trending markets but when the market is trading sideways or is "whipsawing" our strategy is behaving in a contrarian fashion, reducing exposure, and we continue to generate returns.

HedgeNordic: How do you explain your outperformance in 2004?

Oliver Prock: I guess the answer is in the adaptive style being able to trend follow and being able to be contrarian

HedgeNordic: You have been trading the strategy since 2003, has the system undergone any significant changes over time and if so what are these changes?

Oliver Prock: Since 2003 the strategy itself has remained largely unchanged. We have added some markets but the strategy has stayed true to its design, being able to adapt to different market environments. Before 2011, we would have said that there was no market environment that we could not handle. Since 2011, as has been widely discussed in the CTA world, global markets have structurally changed with the most important difference being the politically motivated manipulated environment that has caused problems for many systematic managers. We have dealt with these changes proactively; not by changing our model but by changing the way we execute our trades in terms of optimizing time to place an order to market. This “enhancement”, that we implemented in 2012 has had a profound impact as it has enabled the model to effectively deal with the new manipulated market environment. Our adaptive strategy is now, once again able to apply itself “full throttle” to the new environment. Being “adaptive”, we are not locked into pre-determined time frames as many CTAs are. We use no technical analysis in our trading. We are a statistical, price-forecasting model that alters its style of trading according to the market conditions that it finds itself in.

HedgeNordic: The performance of CTAs has been “flatish” ever since the record year in 2008. This year however CTAs are once again in the spotlight with many strategies outperforming the hedge fund industry as well as global equities. What do you see as the explanation to the long period of non-performance and the sudden pick up?

Oliver Prock: The simple explanation for the “flatish” period and the recent pick-up in performance of many CTAs is the recent reduction in outside influences in the markets. QE is coming to an end. Politicians are less involved in the markets and frankly, trends are being allowed to run their course.

HedgeNordic: What do you see as the unique characteristics with the DMX?

Oliver Prock: Without wanting to repeat what I said earlier, what makes us unique is that we broke away from the approach of using technical analysis more than a decade ago. Our strategy is based on probabilities and uses statistics to forecast future prices. The accuracy of those forecasts help determine our level of conviction to each of the 70-100 managed futures markets that we trade. The net result of this process is that we cannot be described only as a long-term or short-term trend follower or as contrarian. What makes us unique is that we are all of these but only when it is appropriate to be so. We adapt our trading style depending on the environment that we find in each market that we trade. Our portfolio is built on a bottom-up basis so at any one time part of the portfolio could be trending and part could be contrarian. We know of no other manager that can do this, and we believe that our risk-adjusted returns are as a result superior to other managers. Not only this, but our correlation to other managers tends to be very low, due to the very different, yet proven way that we trade.

HedgeNordic: What is currently the strength of your forecasting signals, what kind of market environment is the models telling you lies ahead?

Oliver Prock: We do not look further out than tomorrow’s prices, but the strategy will quickly react to whatever environment it encounters. It has done so now for eleven years and we see every reason for it to continue to do so. This year so far, for example, we coped brilliantly with what was widely considered a tricky market environment in the first six months. We consistently put in good returns whilst others were finding it tough. We are now +18% to end of October and are confident that the pattern will continue.

HedgeNordic: Looking at the margin exposure, almost half of the risk is within equities, is that by design or a reflection of current trends (ie is the graph a snapshot or a longer term average?)

Oliver Prock: Let me correct you here, please. Our portfolio is always very diversified and will within certain risk management constraints, go to where it sees, on a “probability” basis, the most likelihood of being able to predict the future price of that market. Our presentation contains a snapshot of a portfolio of Sector Margins divided by total margin. Here is an example: You have three sectors A,B,C with 10% total margin and 3.33% margin each. So your cake will show 33% Sector A, B and C. Now you close Sector C which is actually a risk reduction and now there is only 6.67% total margin with 3.33% margin in Sector A and B. Your cake will now show 50% Sector A and B looking like more Exposure to Sector A and Sector B but actually it means you have less total risk in the portfolio.

In reality, the portfolio is very active and can alter dramatically over a short timeframe but generally will include a broad number of sectors, without special emphasis on any one. If equities are strongly trending then we may put a higher allocation to them but this is certainly not the current case. An integral part of our inbuilt risk management is that returns are smoothed out by diversification. Unlike some other managers we have not put special emphasis on eg cash equities but our track record reflects the same model with the same rules governing diversification since inception.

HedgeNordic: Looking at past events, how quick is the system to close down position/sector/portfolio? When was the portfolio last closed out?

Oliver Prock: We have a control within the strategy that will, on certain conditions, immediately close out positions, then sectors and lastly the entire portfolio. Fukushima was a good example of this control being put to work. 9/11 was another example. We have never had to liquidate the entire portfolio in one go.

HedgeNordic: Finally, do you have any market wisdom to share with us?

Oliver Prock: Investors believe that CTA’s only made money being long in bonds in the past twenty years. I do not think it is so simple but next year could be an interesting year to test that statement. We think that even though there will be no pressure on bonds prices since the FED will instead of selling off the bonds from the balance sheet prefer to let them mature, there will be some technical opportunity next year and we will very likely see falling bonds prices. In any case it looks like we are probably positioned more on contrarian side and not so much on trend side in 2015. I am looking forward to talking to you about this in a year.