Fundamentally Driven

Stockholm (HedgeNordic) – After a period of drought, 2020 was a good year for CTAs. CTA indices advanced broadly, with the CTA sub-index for the Nordic Hedge Index, for instance, advancing by 4.2 percent during the year. In this heterogeneous space with many different approaches, styles, and strategies, some stars shone brighter than others, and some appeared in the sky as high voltage bolts of lightning.

Volt Diversified Alpha Fund returned beyond 40 percent in 2020, over 22 percent in the first quarter, and 11.5 percent alone in March, when many other CTAs struggled. The average CTA would have gone into the volatile period that initially saw global equity indices sharply declining, with strong, long positions. Whereas many funds, hedge funds, and CTAs were caught flat-footed by the coronavirus-fueled market sell-off, Volt Diversified Alpha successfully captured trends triggered by the deteriorating sentiment.

Fundamental Edge

"When volatility picked up in late February and onward, there were a lot of noisy signals from market prices. If you are price-based, volatility is your enemy," Patrik Säfvenblad, Volt's CIO explains. Market volatility often means that fundamentals have changed, and that markets are searching for a new equilibrium.

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In contrast to many other commodity trading advisors, price data is not the key driver for entering or exiting positions for Volt. “We observe market prices, and they help determine things such as timing or stop losses. However, we are not actively basing our positions on market prices,” explains Säfvenblad and continues, “fundamentals are a far superior indicator to predict market developments.”

“In the two major market moves of 2020, the initial crash triggered by the pandemic and the following rally supported by economic stimulus, fundamentals behaved largely normally and we were able to predict moves early, ahead of the curve,” Tommi Lindeman, Volt’s Head of Business Development observes. Volt, therefore, relies on fundamental data for its trading signals.

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The manager’s models are classified in five main groups: market fundamentals, economic data, market sentiment, relative value and calendar effects. Market fundamentals host the highest risk allocation based on expected returns and the low correlation to other models. They could include mining output, shipping activity or weather data. An especially wet or hot period in the American Midwest, for instance, during harvesting or planting season may give good indications on the future pricing of wheat, or other grains.

“You can see Volt as a conglomerate of many market specialists. There are many specialist ideas, and key market factors driving individual markets,” explains Lindeman. “Some of our modeling would be looking at a market just as a discretionary trader in a specific market might. Weather data is crucial for someone trading grains but largely irrelevant for a metals trader.”

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The portfolio breakdown, too, shows a sector diversification that is distinct from most peers. Exposure to equity indices, for example, only account for 11 percent of the portfolio, whereas metals, softs, and energy combined account for more than half the portfolio, the remainder falling to fixed income and FX.

Well over 8000 independent, bottom-up signals feed 200 different fundamental models weighted by their expected contribution in the current market regime.

Machine Learning and Smooth Operations

Machine learning supports areas such as data collection, signal generation, and real-time execution. Machine learning also evaluates each model and market based on expected contributions in the current environment. "We have an open architecture, and new models coming up from research are straightforward to plug in. However, our machine learning framework will determine if and when these new models will be allocated to, and to what extent," Säfvenblad explains.

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Säfvenblad is pleased that operations worked smoothly and uninterrupted even in the volatile markets of last spring and under work-from-home conditions. "It gave us the opportunity to stress test the entire system in a real-life environment, and every part of it worked to perfection," he says. There were also no hiccups with external service providers such as the fund's administrator, Northern Trust, and clearing broker Goldman Sachs. "Here, our investment in a robust infrastructure and an institutional quality operational setup really paid off."

Risk Management in DNA

> "Risk management is inherent in our DNA."

Säfvenblad stressed that 2020 was the year of risk management where all could be won or lost, showing that Volt Diversified Alpha was built with risk management in mind, maybe more than anything else. "Risk management is inherent in our DNA," Lindeman explains. "Risk management stretches from a model level, to portfolio construction, trade execution to operation. It covers all areas; from investing in diversified, liquid markets, having a bottom-up view rather than having a biased in-house view, not making use of high leverage, working a disciplined reduction of losing positions with stop-loss in every market and more."

"Getting your stop-losses right, determining which positions to keep or cut is one of the hardest achieved, but most crucial part of the secret sauce to a good risk-return profile," explains Säfvenblad. "Getting stopped out too often can be costly, and then, when do you get back in? The period of March to April was a perfect example of there being no point in getting back in too early."

Virtual Process, Real Investors

Volt Diversified Alpha Fund, launched in March of 2017, reached its three-year track record last year. This, in combination with the strong performance shown during 2020, has enabled Volt to attract new investors with fresh capital to the fund. "We onboarded new investors and managed to grow assets under management during the year. The entire process from due diligence to investment was done remotely through digital channels," Lindeman explains.

This article featured in HedgeNordic's 2021 "Nordic Hedge Fund Industry Report."