

Whitepaper

Why Alpha Titans?

*A Solution to Maximizing Return
while Minimizing Risk in Hedge Fund Investing*

ALPHA TITAN: An alpha-return investment manager that has achieved far superior risk-adjusted returns than its peers through skill-based investing. An Alpha Titan possesses a superior investment edge that has enabled them to become a dominant professional in their field of specialization.

© Copyright. 2007, updated 2009, ALL RIGHTS RESERVED,
Tim McCormack, Chief Investment Officer, Alpha Titans LLC.

Why Alpha Titans?

Why diversify among the most proven and dominant multi-strategy alpha managers versus single-strategy alpha specialists?

...because it is the most elegant solution to maximizing return while rigorously minimizing risk in hedge fund investing. It enables one to acquire nearly identical alpha exposures as diversifying among a large number of single-strategy alpha specialists, yet incorporates additional alpha opportunities and far superior risk management than can be achieved through single-strategy specialists.

The arena of alpha-return investing has evolved and changed in meaningful ways that now have significant implications for alpha-return investors. This evolution has reached the stage where these changes result in a more efficient way to maximize return and minimize risk, yet this meaningful implication has not been recognized by most investors.

The investment thesis set forth in this whitepaper is the result of several bottom-line conclusions regarding the major competing forces at this stage of evolution in the hedge fund industry, and their implications in harvesting alpha and managing risk. The thesis concludes that a portfolio designed to be in alignment with certain forces that exist at this stage of evolution result in: a *superior investment-edge* and *superior risk management*

Significant events have recently occurred in the hedge fund industry (most notably the quant crisis in August 2007, and more recently in the financial crisis of 2008-09) that enable a valid conclusion to be made that a significant level of overlap of alpha-exposures now exists between certain types of alpha-return managers in the hedge fund industry – specifically, between dominant multi-strategy managers and single-strategy managers. The magnitude of overlapping exposures between these two types of managers has meaningful implications. This investment thesis concludes that the most intelligent bet at the moment lies with the most dominant multi-strategy managers – the Alpha Titans.

Here is why:

Diversifying portfolio assets through external specialists involves two fundamental bets: 1) a *People Bet*, and 2) an *Investment Strategy Bet*. These coexisting exposures comprise one's investment-edge (or lack thereof). Any superior portfolio diversification methodology MUST incorporate a superior People Bet and a Superior Investment Strategy Bet.

First, the People Bet:

The People Bet implicit within an Alpha Titan portfolio is on the most proven professionals who have outstripped their peers in maximizing return while minimizing risk in the arena of alpha-return investing. These dominant multi-strategy managers have demonstrated great command of the relevant variables in their multiple fields of specialization. These specializations include: *harvesting alpha* across a range of strategies, *managing risk*, and *business strategy*. Through superior execution of their investment strategy and business strategy, a few select multi-strategy specialists have achieved the status of an “Alpha Titan”.

As a result of their success, these Alpha Titans are now in possession of: 1) *significant financial resources*, 2) *experienced teams of vertical investment specialists*, and 3) *superior investment technology*. This combination of factors gives them a significant competitive advantage in ways that may not be initially apparent. It ultimately results in superior actionable information flow that can be exploited in a number of additional ways, resulting in a superior investment-edge.

The substantial assets in the hands of top Alpha Titan managers are now deployed among a vast range of alpha strategies and an ever-expanding universe of financial instruments and opportunities. The magnitude of specialized trading that now occurs across a large universe of asset classes and financial instruments has resulted in a unique level of actionable information flow. It has also resulted in very strong fiscal relationships with multiple brokers who are capable of providing additional actionable information flow. These two sources of *superior information flow*, combined with experienced teams of vertical investment specialists and superior technology, have resulted in additional opportunities to generate alpha and manage risk. These collective factors now magnify the ability of Alpha Titans to dynamically diversify assets in an increasingly opportunistic and intelligent manner. It is important to understand that this specific combination of factors did not exist to any meaningful degree just a few years ago – it has largely evolved over the last three to five years.

This level of superior information flow and the depth of knowledge and technology required to exploit it is a significant achievement that must be acknowledged. It now provides Alpha Titan managers with additional investment opportunities and additional actionable information flow that is not available to single-strategy specialists. This accomplishment translates into meaningful competitive advantages in generating alpha, and in risk management, versus single-strategy specialists.

Second, the Investment Strategy bet:

Unlike *beta strategies*, which have a market-based investment edge, *alpha strategies* require a skill-based investment edge. This distinction makes the importance of the skills of individuals who are developing and trading alpha strategies dramatically more important than the skills of beta managers.

Additionally, diversification is the single best risk management tool and top Alpha Titan managers employ far greater levels of alpha diversification than any other type of investment manager.

The investment strategy bet within top Alpha Titans is highly diversified among *many different alpha strategies* that exploit *many different alpha-return phenomena* in the financial markets. Additional types of meaningful portfolio diversification include *multiple asset classes* (equity, fixed income, currencies, and commodities), *multiple financial instruments* (listed equities, options, bonds, futures, foreign exchange, ETFs, derivatives, etc.), and *multiple geographies* (most Alpha Titans trade global portfolios with a primary focus on the large liquid markets in the U.S., Europe, Asia, Australia, and smaller yet increasing levels of exposure in emerging markets).

Importantly, prior to the last few years there was no reason to believe that many of the teams of single-strategy specialists within top multi-strategy managers were competitive with top external single-strategy managers. This competitive gap no longer exists. The teams of specialists within many top Alpha Titans have evolved in ways that make them extremely competitive in providing nearly identical alpha exposures of independent single-strategy specialists. While the overlapping exposure between individual teams of specialists may average only 25%-35%, once one aggregates the teams of six or more Alpha Titan managers, the total combined exposure appears to have close to 100% overlap with most single-strategy alpha specialists. This evolution has significant implications. It means that nearly identical alpha exposures can now be acquired through utilizing dominant multi-strategy managers (Alpha Titans), while also incorporating their additional meaningful advantages.

The large magnitude of portfolio exposures that occurs within dominant Alpha Titan managers results in *superior information flow* that enables these managers to generate additional alpha and manage risks in ways that are unavailable to single-strategy managers. Advantages include:

1. Portfolio Optimization: Top Alpha Titans possess sophisticated computer technology that enables them to rank the relative attractiveness of the investment opportunities available across multiple strategies, asset classes, industry sectors, and financial instruments on a real-time basis. This superior information flow translates into the ability to opportunistically reallocate assets between different strategies and financial instruments based upon their relative level of attractiveness. Their ability to dynamically rank opportunities on a real-time basis (in expected return, expected risk, and expected correlation) increases their ability to dynamically exploit the most attractive opportunities available and better manage risk. The importance of this information advantage cannot be overstated. When properly used to dynamically reallocate assets, it results in superior alpha generation and in superior risk management.
2. Opportunistically exploiting dislocations: Market dislocations often result in significant mispricings that cannot be identified through technology. Strong fiscal relationships with multiple brokers combined with their experience across multiple asset classes results in a number of low-risk alpha opportunities that are not often available to single-strategy specialists. An example of such opportunities is forced sales of portfolios of other market participants during market dislocations.

Any drawbacks? ...a tradeoff.

Transparency has recently become a buzzword in the investment industry and some investors demand complete transparency. These investors typically believe it is their job to look over the shoulder of their money manager and second-guess or verify all investment allocations. This approach requires total position-level transparency and requires being smart enough to know what to do with this information. This typically requires knowledge as deep as the specialist – which is increasingly a challenge in this field of many highly specialized disciplines. In short, if an investor demands position-level transparency then a portfolio of superior Alpha Titan managers is not a viable option.

It is very rare to acquire position-level transparency with top Alpha Titan managers. While portfolio risk exposures are typically provided by Alpha Titan managers, this risk-level transparency is fundamentally different from possessing position-level transparency. Risk-level transparency usually provides reporting by: asset class, geography, strategy-type, and other high-level views, yet it does not reveal each portfolio position.

There is a good reason that top alpha-return specialists are reluctant to reveal their individual positions. It would be foolish for any manager who has developed a lucrative investment-edge in a specialized niche to openly provide information that would allow others to identify their specialized methods and techniques. Providing access to proprietary bottom-line information would simply help educate others how to become a competitor in their lucrative niche.

An analogy may help clarify this point. If you knew of the location of a large deposit of gold and had begun to profit from it, yet this location was unknown to others, would it make sense for you to reveal information about where the gold was located and how to mine it? ...of course not. Superior investment managers are very bright people. Why expect different behavior from them? Preserving ones investment edge is vitally important and the desire to protect it is simply human nature. The most lucrative investment strategies will always be the most highly guarded.

The significant drawback of demanding position-level transparency is that it cripples one's ability to hire superior Alpha Titan managers and employ the most lucrative investment strategies. If you are an investor that demands position-level transparency you will never be able to diversify among the most successful alpha-return managers in the hedge fund industry.

Rather than giving allegiance to position-level transparency, the approach used by the Alpha Titans strategy gives allegiance to the dual objectives of *maximizing return* and *minimizing risk*. In this regard a calculated tradeoff is being made to utilize the most proven specialists (*the superior People Bet*) at the expense of position-level transparency. When executed properly, incorporating a superior People Bet in the portfolio is believed to be the most intelligent tradeoff.

Conclusion

From the standpoint of diversifying among different alpha-generating strategies, the levels of diversification offered by dominant multi-strategy managers are a quantum leap above all other types of investment managers.

The diversification achieved within a portfolio of 10 to 15 top Alpha Titan managers integrates superior diversification within both the *People Bet* and the *Investment Strategy Bet*. Focused concentration is taken in the People Bet, while the Investment Strategy Bet is extremely diversified in multiple ways. The underlying Investment Strategy Bet is highly diversified among hundreds of different alpha-return strategies, across thousands of financial instruments, and encompasses all major asset classes on a global basis.

A portfolio of superior Alpha Titan managers is the most elegant way to maximize return and minimize risk in hedge fund investing. Such a portfolio integrates the security inherent in partnering with the best and the brightest minds in the alpha-return industry.

END