

Marc H. Malek

*Managing Partner at Conquest Capital
Group, Systematic Macro and FX Trading
US Firm*

Explains Conquest's short-term systematic trading approach with a trend-following bias, and how the use of several strategies and quantitative models can ensure disciplined investment decisions.

Interview by JW Partners for FX Trader Magazine

INTERVIEW



Manager	Conquest Capital Group
Strategy	Conquest Macro FX
Location	New York
Assets Under Management	660 mln Usd
Type	Long Vol / Momentum
Style	Fundam Systematic ental
Instruments	OTC, FX Spot and Forwards
Currencies	Australian Dollar, British Pound, Canadian Dollar, Euro, Japanese Yen, Swiss Franc, British Pound / Japanese Yen, Euro / Japanese Yen, Danish Krone, New Zealand Dollar, Norwegian Krone, Swedish Krona

JW: Is FX a unique market? In what trading currencies is different than trading other financial instruments?

MM: FX is unique in that it has historically been a 24-hour market and is liquid at virtually any given point in time, including periods where exchanges are closed. This difference creates a level of gap risk that is not present in other markets.

Although the advent of 24-hour electronic trading has changed the landscape to some extent, other instruments are still keyed off of exchange trading hours and see liquidity deteriorate during off-hours periods. Moreover, because FX has historically been a 24-hour market, 24-hour models built on past data are more reliable because they are

trading FX as it has always been traded as opposed to the manner in which the market has evolved over the past few years.

JW: When and why did you decide to create Conquest created?

MM: Prior to launching Conquest I ran Exotic Derivatives in FX at UBS as well as FX Proprietary Trading for the merged SBC/UBS bank in Europe and the U.S. I built and managed businesses in foreign exchange, derivatives in the U.S., Europe and Asia. While managing these businesses it became clear to me that emotions can end up playing a negative role in trading decisions. Most professional traders have clear trade-entry algorithms in mind.

Certain events have to occur before a trade is initiated. Typically, before the trade is put on, the trader sets pre-determined stop-loss and take-profit levels. In reality, however, most traders let losses run beyond their stop-loss and take profits too early. A system, however, will execute the same trade ideas without the risk of emotions coming into play. If the trader has a good strategy, a system will execute it more efficiently.

Given our strategy however, we were not just looking to create an absolute return portfolio, but rather a combination of absolute return and portfolio hedge product. We desired to create a product that would produce significant returns during systemic shocks such as 1998, 2002, and 2008.

JW: how is the company structured today? What are the key positions in an FX Management company?

MM: Conquest Capital Group is based in New York with a current headcount of 12 people. As anyone would suspect, our quantitative research team is vital to the success of our business. That being said, our middle and back office and IT teams keep the business running smoothly. People often underestimate the importance of these roles.

JW: Which authorities regulate Conquest? Do you keep and update procedure manuals, and a compliance and risk management policy? how time consuming and how important is it to satisfy regulation requirements on one side, and internal procedures on the other?

MM: Conquest Capital LLC is registered with the Commodity Futures Trading Commission as both a commodity trading advisor and a commodity pool operator and is a member of the National Futures Association in such capacities.

We are very proud of the compliance and risk management policies and procedures that we have instituted within Conquest. Our internal documents such as our Compliance Manual, Employee Manual, and Business Continuity and Disaster Recovery Policy are updated at least annually and all members of the firm are required to sign an affirmation to acknowledge their understanding of the contents contained therein. With the proper policies in place, and the culture of the firm established, we feel our internal procedures and controls

actually go above and beyond our regulatory requirements. It is with this proper foundation and culture of compliance that makes ongoing maintenance a much less burdensome task and general revisions and routine testing become familiar aspects in our ordinary course of business.

JW: how would you describe your investment strategy?

MM: Conquest Macro FX is a short-term systematic trading strategy with a trend-following bias. Research has shown that new information is not assimilated instantaneously by all market players. Prices move in "random walks" with mean reversion in trading ranges most of the time when supply and demand are in balance and trend the remaining time due to supply and demand imbalance as information is absorbed in the market. Put more simply, markets spend short periods of time going to new trading regions, and most of the time consolidating in those regions. Some factors that affect the existence of trends are:

- 1) Information often comes out gradually. For example, the state of an economy is implied in a plethora of economic statistics that come out one at a time.

- 2) Monetary policy changes are implemented incrementally rather than in one large move.

- 3) Information might require analytical processing, which is not instantaneous.

Information inflow is continuous, and so is the absorption process. As more and more players react to news and enter the market, the market trends. The existence of

trends is verified by academic research, which shows skewness, kurtosis and auto-correlation beyond what one would expect from the random walk theory. however, it is critical to apply disciplined risk control when trading, as one cannot know for sure when a trend is starting or ending. Not all trades will be profitable, but disciplined money management will ensure that drawdowns are kept to an acceptable level while waiting for the next profitable trend to start.

JW: how and when did you develop your current FX management strategy?

MM: The system has been trading since May 1, 1999. however, the composition of the program has evolved over time as new systems have been added and markets have been adjusted.

JW: Risk, an exciting yet dangerous word. how do you manage it?

MM: Risk management is inherent to our goal of maximizing the average return divided by the largest cumulative drawdown. After creating a robust system and a well-diversified portfolio that maximizes our return relative to this largest drawdown, we select our level of exposure so that the maximum hypothetical drawdown is well below our acceptable real-time drawdown level.

JW: Do you use a blend of strategies for diversification?

MM: Conquest uses quantitative models to ensure disciplined investment decisions. In order to maximize the diversification benefits of the currencies traded, Conquest uses several trading strategies. Within each strategy, the parameters are the same



for all currencies traded. Each strategy takes advantage of trends that occur in different time frames, and works totally independently of the other strategies. What is considered trend-following in one time frame is counter-trend in another timeframe.

The first strategy exploits short-term price/time/volatility relationships. The strategy looks for certain short-term price/volatility relationships to enter the market. Specifically, it takes advantage of low market volatility points where one can enter with a high reward potential (a tight stop with low likelihood of being stopped out due to market noise). The second strategy looks to capture market movements that constitute a short-term trend. The third strategy exploits counter-trend opportunities within longer-term trends. The fourth strategy

selectively captures risk premium from the markets and is only employed during risk-seeking environments, which tend to exhibit lower or depressed volatility over extended periods.

JW: how do you think your performance has been over time? What market conditions could have a positive or negative impact on it?

MM: Since our inception, Conquest Macro FX has delivered on its mandate to outperform in high volatility environments. The program has proven to be a great diversifier for almost all portfolios.

Short-term trends with consolidation and continuation periods are most beneficial to our systems. We expect to particularly outperform the competition when long-term trends reverse, as our shorter-term systems are quick to enter trades against long-term

trends. We will experience difficulties in periods where a directionless market has high volatility on a daily basis.

JW: Do you use less mature currencies?

MM: We do not. Liquidity is the first and most important criterion in selecting markets for the portfolio.

JW: Do you think some of the less mature currency pairs are viable for individual traders, who don't have to worry as much about huge liquidity? Would you suggest to trade them?

MM: Each trading strategy is suited to trading a different set of markets. Our strategy is much more short-term and thus demands that the instruments traded are extremely liquid. The inability to execute a trade without significant slippage would have a material effect on our performance. If a strategy has a trade horizon of 1-2 years,

the universe of acceptable markets would certainly be larger because a bad fill would not ruin the profitability of a trade. That said, as one begins to trade less mature currency pairs, gap risks and fast markets become much more likely.

JW: When developing strategies, how do you allocate your time between building entry signals, exit signals and money management rules?

MM: We have found that every strategy generates alpha in three ways: entry criteria, exit criteria, and money management. We tend to devote equal attention to each of the three components because each one is essential. However, each system will have its own unique traits and composition. Certain trading systems will emphasize the entry signals and use more generic exit strategies, others will emphasize the latter. The important consideration is that it is essential that the strategy be robust and that the model does what it is supposed to do.

JW: how much time do you allocate to research and development of existing or new strategies?

MM: We continuously attempt to expand the number of systems and markets without changing the core risk parameters and return profile of the program. In January 2002, we expanded short-term trend-following and short-term trading strategies, while eliminating our long-term trend-following strategies. We believe that long-term trend-following returns are commoditized and there is no alpha to be derived in that space. Consequently, we can achieve a higher Sharpe ratio by being more short-term oriented.

In March 2005, we integrated two

of our major research studies into the design of Conquest Macro FX. These studies covered the relationship between short-term strategy returns and market risk appetite. Conducted in parallel, the studies produced two significant conclusions:

1. The general risk appetite level of the market environment can be measured and that it tends to change slowly over time.

2. Short-term trend-following strategy returns provide conditional long-volatility exposure (i.e. they exhibit high correlations to the change in volatility when volatility rises significantly but are only slightly correlated to the change in volatility when volatility rises slightly or declines).

Using the proprietary metric we devised to measure market risk aversion, our Conquest Risk Index, we observed that market risk appetite was quite high at the time. This period of risk accumulation created an environment that would likely continue to be unfavorable for Conquest Macro FX's long-volatility strategy. The latter conclusion left us confident that we could preserve our long-volatility profile should there be a rise in volatility while reducing the drag on Conquest Macro FX's returns. harnessing these two effects led us to adjust Conquest Macro to become a dynamic strategy allocating risk based on the risk environment among our sub-strategies.

In 2010, we improved the strategy further by integrating our environmental analysis with observations regarding downside exposure. This refinement is an extension of the research that led to the 2005 strategy enhancement. Whereas the prior enhancement

focused on the composition of the portfolio but kept leverage more or less constant, this enhancement adjusts both the leverage and system composition of the portfolio.

JW: Do you believe in ever-valid rules, or every strategy loses its accuracy sooner or later? have you ever found strategies that come back into phase after a long time in negative?

MM: I think the performance of trend-followers over the past 30 years suggests that trend-following has been a fairly robust, if unspectacular strategy, even with its drawdowns. Within our strategy, we have models that been trading since 2001 or earlier and are still profitable. Models tend to fail for a number of reasons, but here are five of the most common:

1. They are over-optimized
 2. They require more liquidity than is reasonably available in the market
 3. They attempt to exploit market behaviors that no longer exist
 4. They attempt to exploit market behaviors that occur infrequently
 5. They have significant tail risks
- Models that come back into phase typically either work infrequently or exhibit sufficiently large tail risks that they are removed from trading. The risk is that it is difficult to infer whether a model will continue to generate gains after a profitable run unless it is possible to identify the factors that contribute to its success and determine whether those factors are present at any given time.

JW: Do you adjust to cope with new market conditions?

MM: No, our system parameters are not changed to meet market conditions.

The systems are designed to adjust to changing market conditions.

JW: Do you favor any particular time frame in your strategies? What is your average trade duration?

MM: Conquest Macro FX is a short-term strategy with average trade duration of 6 days. We believe that long-term trend-following returns are commoditized and there is no alpha to be derived in that space. Consequently, we can achieve a higher Sharpe ratio by being more short-term oriented.

JW: What should an inexperienced trader watch when choosing a time frame?

MM: Each situation is specific, but I can tell you that you should not trade a strategy for which you do not have the time or resources.

JW: What are your average and maximum leverage levels?

MM: Our average margin-to-equity ratio over the past five years has been roughly 7.50% and has been below 25% more than 99% of the time over the past five years

We maintain a strict margin limit of 33% to limit tail risk due to excessive exposure and position concentration. This limit is rarely even approached.

JW: how many execution brokers do you use? how do you split execution between electronic and voice?

MM: We use a wide variety of counter-parties, certainly in double-digits. The majority of our execution is voice or agency execution, although we use electronic execution for a significant percentage of our market orders.

JW: What historical data do you use in developing your strategies?

MM: We have tested our current strategy and market portfolio for the period beginning with January 1990. This testing period is representative of a wide range of market conditions, provides a large enough sample size per system and includes difficult trend-following periods, such as 1994 and 1999.

JW: Which tools do you use in the strategy development process?

MM: The strategies are programmed using our own proprietary model evaluation system and positions are managed using our proprietary trade generation and entry database. These two databases read the same decision code, so models developed in the testing database translate directly to the order generation database. We also use an "off-the-shelf" package for additional validation of the testing results.

JW: how does liquidity impact the efficiency of your strategies? have you already explored to what AUM limit the strategies would allow you to grow to?

MM: Short-term strategies are heavily dependent on liquidity hence we restrict our strategy to the most liquid currency markets. Trade size does not grow linearly with assets, however. We have devoted a significant amount of research to signal diversification and have a large library of systems that have been developed over time. With the constant evolution of our trading strategy, we have been able to diversify the number and type of models we trade.

I believe that the strategy can manage at least \$2 billion before there would be any effect from trade size.

JW: What is the single biggest strength of your team? And is there any particular advance that has taken place since Conquest started that has particularly benefited your trading?

MM: The biggest strength of the team is the diversity in background and experience that each person brings to the table. Our two senior research analysts both have trading and execution experience. Our head trader worked as a sell side options dealer. Our COO has worked with a variety of hedge funds at a large investment bank.

The largest advance was the development of the Conquest Risk Aversion Index. The ability to quantify risk appetite has made it possible for us to allocate risk to our portfolio and between our strategies more effectively.

JW: Can you give us your feeling about the evolution of the EurUsd over the next 6/12 months?

MM: The continued instability in Europe and the departure from the Euro as a reserve currency suggest that parity to the Dollar is back on the horizon.

JW: What's the best advice you would give to an individual trader and to a semi-professional trader who wants to enter the FX fund management industry?

MM: It is a very exciting and rewarding space. In general, the most important criteria for a successful trader are discipline with entry and exits and the patience to let trades come to you rather than chase them or look for them. Overtrading and poor discipline are the two most common causes of losses and blowups.