Conquest Creates New Hybrid Program

By Jacob Bunge, Financial Correspondent
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NEW YORK (HedgeWorld.com)-Managed futures firm Conquest Capital Group earlier this month launched a new trading program that fuses two of the firm's existing strategies and aims to profit in markets both volatile and calm, according to Managing Partner Mark H. Malek.

Named Conquest Carry/Macro Blend, the new program combines the Conquest Macro FX Only strategy with the firm's Carry Capture strategy. The former component is the currency-specific portion of Conquest's $213 million Macro vehicle, focusing on high-liquidity currency pairs trading and managing $20 million as a stand-alone fund; the latter component is an older program focused on currency pairs that are less frequently traded.

Both the Carry and Macro FX Only programs have traded separately since December 2005, according to Conquest, and in that time they have shown a negative 5% correlation. The idea behind creating a hybrid program was to deliver better risk-adjusted performance across a variety of market conditions.

"With Macro, basically the strategy tends to be similar to a long-volatility strategy, whereas the carry strategy tends to be much less so," said Mr. Malek. "So when we put them together, the lack of correlation between the two strategies, while both have positive expectancy, it makes a good combination."

The trading done by Conquest Carry/Macro Blend is 100% systematic, and currently the hybrid program is weighted slightly in favor of the macro component, although this weighting is somewhat discretionary. Weighting decisions are based on signals from the Conquest Risk Aversion Index, which determines whether the current environment qualifies as risk-seeking or risk averse. At present, Mr. Malek said, the firm is anticipating a risk-averse environment, a condition he said will probably last for some time. The weighting of the program also takes into account general foreign exchange market factors.

"We hope that it will do well under most market conditions," said Mr. Malek. "When volatility is going up, we expect Macro to pick up the slack and generate a lot of the returns. When volatility is going down, and things are much slower, we expect the Carry component to do really well. Looking at the returns of the strategy, both actual and hypothetical it's a very even distribution of returns."

One of Conquest's bank clients seeded the Carry/Macro Blend program with $5 million to establish a track record, and the program launched April 1 after a relatively short development period. The program is targeted at institutions like banks, funds of hedge funds and family offices, and Mr. Malek noted that currently it is offered only through managed accounts. This will change as it builds a track record, he said, and a fund will eventually be built around it.

Planned Program and Q1 Performance

Mr. Malek also shed light on a new program Conquest is devising, a long/short equity vehicle that aims to deliver what he terms "alternativebeta." Many hedge funds, he said, do not deliver enough alpha to justify their 2-and-20 fee structure, and the investor ends up paying a high price for returns that aren't much above the rest of the market, if at all.

In 2004, Conquest tested this theory on the trend-following CTA industry, launching a fund that distributes its positions evenly across different futures markets and across different time frames, while charging a 1% management fee and no incentive fee. This fund, Conquest Managed Futures Select, now manages approximately $142 million and has returned 33.3% since inception.

"There are a few overriding factors that determine the returns of a CTA, and those are the time frames you're trading and what market mix you have," said **Mr.** Malek. "From most of our analyses, if you set those factors straight and analyze the performance of the trend-following CTAs out there, you see little difference in terms of their models." Most of the factor bets made by CTAs are cyclical in nature, meaning that while one CTA may be up and another down at one point, in time their positions may reverse due to revolving market trends.

Over time, Mr. Malek said, the Conquest MFS vehicle has bested most CTA indexes on a risk-adjusted basis, while maintaining an 87% to 90% correlation to those indexes and a volatility of 11% to 12%. He said he sees no reason why the program's approach should not work with hedge fund strategies as well.

The mechanical trading rules-based system that powers MFS makes it more nimble than other products that try to replicate hedge fund performance, according to Mr. Malek. Factor models, which seek to replicate an index by duplicating its risk exposures, have difficulty capturing the uniqueness of various hedge fund strategies, whereas the "FundCreator" method of replication, devised by Harry Kat at City University's Cass Business School in London, carries too many uncertainties and not enough transparency.

At the end of March, Conquest's $213 million Macro program was up 22.2% for the year, with much of the program's 4.1% return in March coming from short-term, long- volatility bets, as well as currency positions. The $142 million MFS program returned 10.4% over the first quarter, taking a 1.9% drawdown in March due to losses in agriculture and base metal trades. The FX Only program was up 15.4% at the end of the quarter.

Harder hit by commodities losses was the Conquest KCM Agricultural Commodities Plus Fund, which launched in December and was up about 25% year-to-date by late February **Previous HedgeWorld Story**. Despite a 12.3% loss in March, the program remained up 8.3% for the year as of March 31, with about $93 million under management.

"March was a tough month," said Mr. Malek. "But that was somewhat expected after the month we had in February, when it was up so much. I can't say that we saw the extent of what happened in March coming, but in February, we saw that some of those moves were going totally parabolic, and a pullback would totally be I order. As a result, we lowered the leverage on the strategy in February, and that helped a little bit in March."

Conquest, established in 2001, manages a total of $569 million.

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