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Camelot Partners

Breakout volatility

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Breakout volatility

A focus on positive expectancy and no correlation

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Vital Statistics

Assets under mgt	
Conquest Macro	$370 million
Currency Only	$18 million
Conquest Protector	$15 million
Minimum investment	$250,000
Registration	CFTC
Fee structure	
Management fee	1.5%
Incentive fee	20.0%
Avg commission	$7/roundturn
Ratios	
Avg margin-to-equity	10.0%
Ann comm-to-equity	2.1%
Avg Roundturns/$M/year	3,200
Auditor	PricewaterhouseCoopers

Richard Silver and Marc Malek

Marc Malek and Richard Silver, the founding partners of Camelot Partners, have worked together for the better part of eight years. They first met at Union Bank of Switzerland in 1995, where they built and managed businesses in foreign exchange, derivatives and emerging markets in the US, Europe and Asia.

Following UBS's merger with the Swiss Banking Corp in 1998, they added global proprietary foreign exchange trading to their responsibilities for global foreign exchange derivatives and exotic options.

Malek first became interested in the formulation of computer-based decision systems while studying at the California Institute of Technology. He was able to put his interest into practice at KB Currency Advisors, a $400 million hedge fund, where he built trading systems. Later at UBS, he first conceived of pairing his quantitative background with volatility in systematic trading.

Malek co-founded Enterprise Asset in 1999, which focused on trend following in different time frames and short-term volatility trading. Enterprise was then dissolved before the founding of Camelot Partners with Richard Silver in 2001.

Today, the majority of Camelot's assets are in Conquest Macro, which has enjoyed impressive growth increasing from about $80 million to more than $370 million in 2003 alone. The program's clients are mostly blue-chip funds of funds and institutional clients.

It has a compound annualized return of 17.7%, which compares favorably with the 9.3% return of the CISDM diversified subindex median.

Camelot also manages Conquest Protector, a short-biased fund with $15 million under management, and a currency-only fund with $18 million.

Insurance of sorts

Conquest Macro trades three main strategies: short-term volatility breakout with a two-day average trade duration; medium-term trend following with a 10-day average duration; and a short-term countertrend strategy with a three-day average duration. Each strategy employs four different trading models—12 models in all.

Within each model, the firm trades more than 35 different markets. Historically, the portfolio has consisted of approximately 40% currencies, 35% fixed income, 15% equity and 10% energies and metals. The firm runs a 24-hour trading desk, which enables it to cover the North American, European and Asian block markets.

All the models have an upside correlation to each other of over 70% and a downside correlation of between 20% and 50%. Camelot believes this correlation skew gives it an edge in achieving a high annual return to worst drawdown.

In addition to producing trading models with low correlations to each other, Camelot aims to achieve a low correlation to other trading advisors. "We try to be the insurance in a portfolio of hedge funds and a portfolio of CTAs," says Malek.

"Clients don't generally mind if all their investments do well at the same time, but what they very much want to protect against is all their investments doing badly at the same time."

The firm achieves low correlation to other advisors by being long short-term volatility.

Volatility is the overriding discipline governing when Conquest Macro enters a market by using each of its three strategies and their four underlying models. It takes a position when volatility is low and gets out when volatility expands, the result being long the volatility of volatility.

Malek describes this approach as a volatility breakout strategy—different from the pure academic definition of long volatility, which is to be long via the purchase of options. The benefit, he says, is positive expectancy and no correlation to other managers.

Camelot's approach gives the firm an edge, says Malek, because it does not have to deal with the effects of time decay, which can cause problems in traditional long volatility approaches when the market is not moving. "In our case, if the market suddenly dies, we just don't take a position, our margin-to-equity comes down and we just wait for things to wake up again."

The risk to Camelot's strategy occurs not because of a lack of market movement, but in a market with small spikes in volatility that do not follow through in the underlying market. This is when the benefits of a portfolio diversified across time frames, models within time frames, markets, sectors and locales kick in, bringing the risk per trade down to between five and 15 basis points.

The importance of this diversification is illustrated by looking at Conquest Macro's annualized volatility on a 12-month rolling basis. It went from 22% at the end of 2002 to 13% in 2003—during which time the firm went from trading three submodels to 12 submodels.

"The challenge was to come up with submodels that had a very high upside correlation and relatively low downside correlation," says Malek. "We didn't want to sacrifice return or change the nature of what we try to extract from the market, but we absolutely wanted to improve the risk adjusted quality of the return."

Camelot Partners

PERFORMANCE HISTORY

May 1999 – September 2003

	Conquest Capital	Median of CISDM Diversified Subindex	S&P
Return(%)			
Annual comp rate	17.66	9.26	(5.07)
1999 (7 mths)	(2.34)	2.30	11.00
2000	43.35	10.78	(9.09)
2001	2.06	4.49	(11.88)
2002	35.32	18.09	(22.11)
2003 (9 mths)	6.07	9.15	14.73
October estimate	(5.58)		
Risk (%)			
Annual std dev	20.81	16.04	17.48
Semideviation	10.49	9.64	12.80
Maximum decline	(10.77)	(18.40)	(44.73)
Return/Risk			
Sharpe Ratio	0.64	0.28	(1.00)
Comparison with CISDM Diversified Subindex			
R-Squared	0.19		
Alpha	0.89		
Beta	0.97		

A focus on drawdowns

When it looks at risk, Camelot considers downside deviation, or drawdown, as opposed to standard deviation. This is a function of the firm's trading philosophy that it is not the upside deviation it should be trying to limit, but rather its drawdown.

"Because we think of risk as drawdown, to have an equal allocation to risk per system, we strive for an equal allocation to our drawdown," says Malek.

This focus on limiting drawdowns is illustrated by the fact that although the annual standard deviation for Conquest Macro is higher than that of the CISDM diversified subindex median, indicating a high level of risk, the program's drawdown is well below that of the subindex.

The historical standard deviation for Conquest Macro is 20.8% compared with a seemingly less risky 16.0% for the median, while its drawdown is a relatively modest 10.8% compared with the median's 18.4%.

Approaching capacity

In view of its recent upsurge in assets, quadrupling the size of the program in 2003, Camelot plans to close to new assets in the first quarter of 2004. At that time, it expects to have in the vicinity of $600 million under management, its earmarked capacity. It already has commitments of $100 million from existing clients.

Malek says the firm has no plans to add additional strategies or models, though research is always going on. "We are not willing to sacrifice the quality of profile of our returns for assets," he says.

Camelot Partners is made up of managing partners Malek and Silver, three people in client relations, four each in trading and research, one financial officer and two in administration.

12-month rolling window of volatility