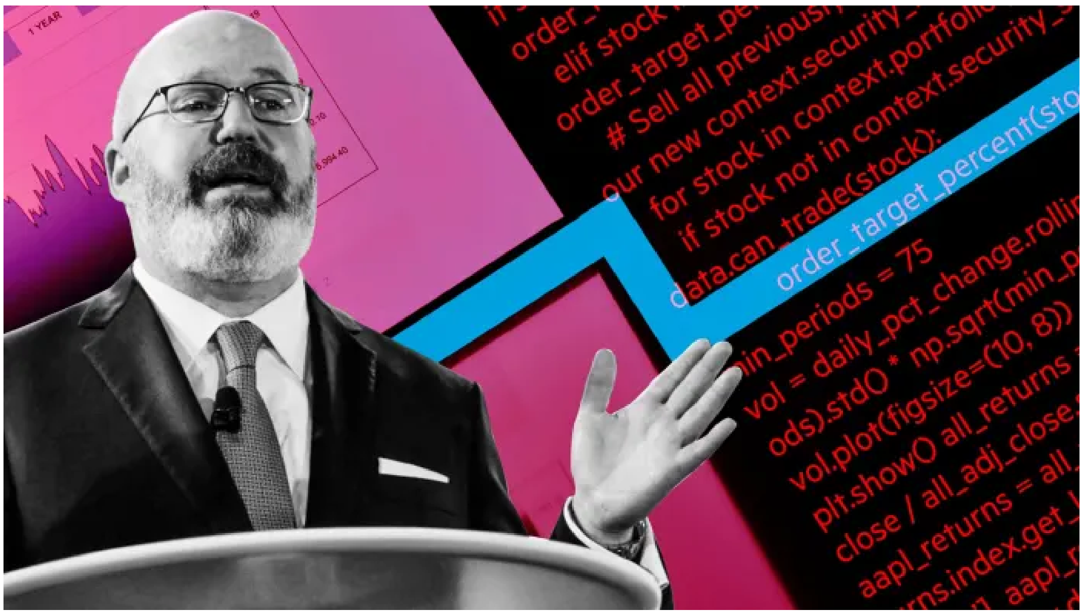
AQR Capital Management LLC

‘Quant winter’ thaw ends long spell of drab returns for funds

AQR among the big names on the rebound as new phase of pandemic shakes up asset markets



Clifford Asness said 2018 to 2020 was the ‘toughest period’ he had yet seen, but early 2021 had been one of the strongest starts to a year © FT montage; Bloomberg

Robin Wigglesworth in Oslo and **Laurence Fletcher** in London APRIL 22 2021

Computer-driven investment funds are rebounding from a painful stretch, with big firms such as Clifford Asness’s AQR posting dramatic rebounds after several years of struggles, cutbacks and multibillion-dollar redemptions.

Few firms were hit as hard as AQR in the “quant winter” that chilled the performance of quantitative investment strategies in recent years, with the firm shedding $86bn in assets from its 2018 peak.

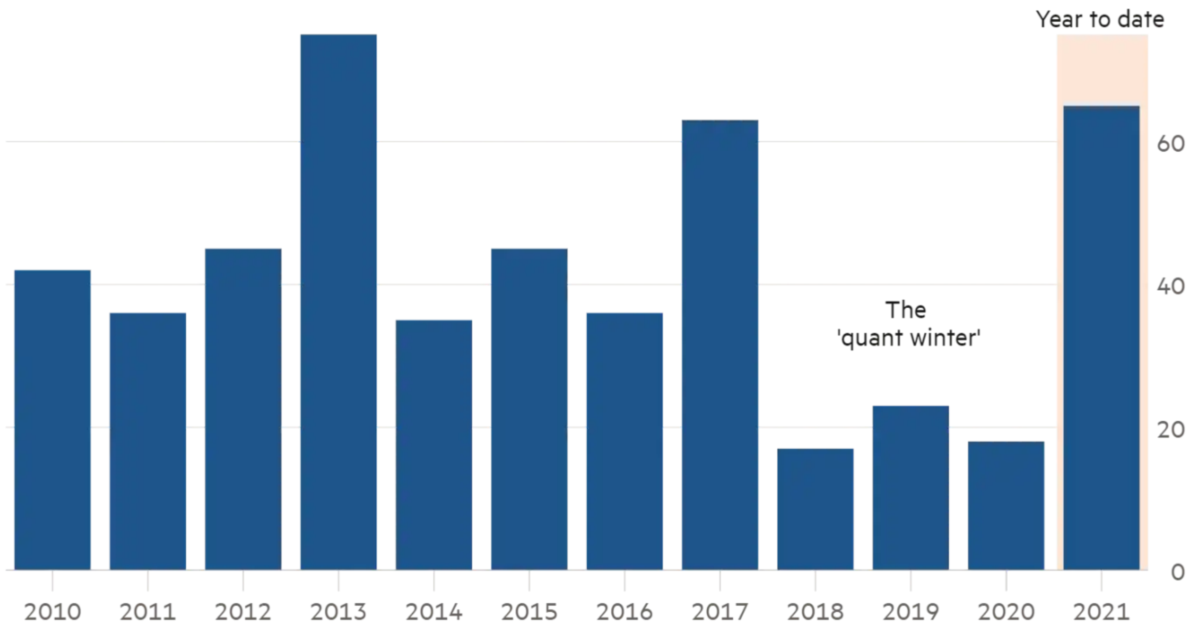
But AQR’s $1.4bn Absolute Return fund — which combines a lot of its strategies in one wrapper — climbed 21.6 per cent in the first quarter, and is now up by a third since the end of September. About 65 per cent of quant mutual funds have surpassed their benchmarks in 2021, according to Nomura. If sustained, that would be the second-best beat rate in at least a decade.

Industry insiders are cautious about declaring a definitive “quant spring”, but the rebound suggests that the long winter might be fading, and that many flagship strategies are regaining some of their mojo. For Asness — who turned to violent video game Doom Eternal to relieve stress last year — the signs are heartening.

"While 2018 to 2020 was actually the toughest period I've seen yet, the first three months of 2021 have made for one of the strongest starts to a year we have had in our history," Asness said. "I wouldn't be surprised if this recovery was the biggest and the longest."

Quant funds' fortunes rebound

Percentage of quant mutual funds outperforming their benchmarks after fees



Source: Nomura
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Quant investing is a broad field. Some engage in highly complex and ultrafast trading based on faint statistical patterns. Others, including AQR, seek to exploit long-term trends known as "factors", such as the tendency of smaller stocks to do better than bigger peers over time.

Just a few years ago, AQR was riding high on the wave of interest in quant investing, systematically mining these factors to become one of the biggest hedge fund groups in the world. It managed as much as $226bn by mid-2018. Many of its strategies then started spluttering, and AQR's assets slumped to about $140bn today.

AQR is also going through an internal shake-up. Ronen Israel, one of its top executives, is now leaving to help start a biotechnology company after 22 years at the firm, while Lars Nielsen, his fellow co-head of portfolio management, is shifting to a more client-focused role, according to people familiar with the matter. That means all of AQR's investment teams will now report directly to Asness and fellow AQR founder John Liew.

Industry insiders offer myriad explanations for why many quant strategies have fizzled in recent years. It has been a particularly nightmarish stretch for the "value" factor, which takes advantage of how cheap securities in the long run tend to beat more loftily valued, glamorous counterparts. Value has done so badly that the strength of other factors has been insufficient to buoy overall performance for quants that exploit multiple factors simultaneously.

The pain was particularly evident last year. In the annual Barclays survey of hedge fund investors, 70 per cent said they had pulled out some or all of their money from "risk premia" funds — as factor strategies are also often called — and not one out of 240 respondents managing a total of $5tn said they planned to increase their allocations.

Value factor roars back

Cumulative returns, year to date (%)

Source: Refinitiv
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However one of the biggest drivers of the tentative quant spring is the renaissance enjoyed by the value factor since last November, and AQR's brighter fortunes now are echoed among other factor-oriented hedge funds.

Systematica's Risk Premia fund dropped 13 per cent drop last year but has rebounded 5.5 per cent this year, while Two Sigma's Risk Premia Strategy lost more than 7 per cent in 2020 but is up slightly this year, according to people familiar with the returns. JPMorgan's Diversified Risk fund lost around 23 per cent last year, but is up around 4.7 per cent this year. The companies declined to comment.

The question is how durable the revival is. Anthony Morris, head of quantitative strategies at Nomura, argues the performance of many major factors is linked to movements in bond yields, and that the industry therefore has to evolve.

"The whole industry is deceiving itself and others that these are independent, systematic factors," he said. "We need to move on. Using new data sources is a way to rescue the quant world from the shackles of fixed income, whether those shackles are recognised or not."

Not all quant funds are enjoying strong recovery either. AQR's Global Risk Premium hedge fund, which was up just 1 per cent last year, is down almost 3 per cent this year, according to performance numbers seen by the Financial Times. Moreover, a rebound "is cold comfort for investors who suffered through years of underperformance [and] then redeemed", said Andrew Beer, managing member at Dynamic Beta Investments.

Jaime Lee, head of quant equity investing at PanAgora, agrees that the industry will in the future have to lean on the more sophisticated signals they are now unearthing with the help of new data sets and artificial intelligence, rather than the basic factors used for the past few decades.

"The quant spring is coming because of the favourable market environment. However the outperformance that we're seeing from new-generation factors is large," she said. "I think that's the future of quant."